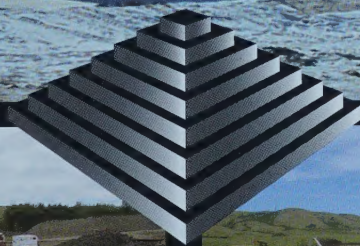


unleashing the knowledge of our people



unlocking value for our shareholders

2001 ANNUAL REPORT

2001 ANNUAL REPORT

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Abbreviations

\$M	thousands of dollars	MBbls	thousand barrels
/d	per day	MBoe	thousand barrels of oil equivalent ⁽¹⁾
ARTC	Alberta Royalty Tax Credit	Mcf	thousand cubic feet
Bbls	barrels	MMcf	million cubic feet
Bcf	billion cubic feet	MStb	thousand stock tank barrels
Boe	barrels of oil equivalent ⁽¹⁾	NGLs	natural gas liquids
GJ	gigajoules	Stb	stock tank barrel

(1) Natural gas is equated to oil on the basis of 6 Mcf of natural gas = 1 barrel of oil equivalent (Boe)

Forward Looking Statements

Corporate information provided herein contains forward-looking statements. The reader is cautioned that assumptions used in the preparation of such information, which are considered reasonable by Lexxor Energy Inc. at the time of preparation, may be proved to be incorrect. Actual results achieved during the forecast period will vary from the information provided and the variations may be material. There is no representation by Lexxor Energy Inc. that actual results achieved during the forecast period will be the same in whole or in part as those forecast.

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LEXXOR ENERGY INC.

FAST FACTS – LEXXOR ENERGY INC. – CDNX: LXX

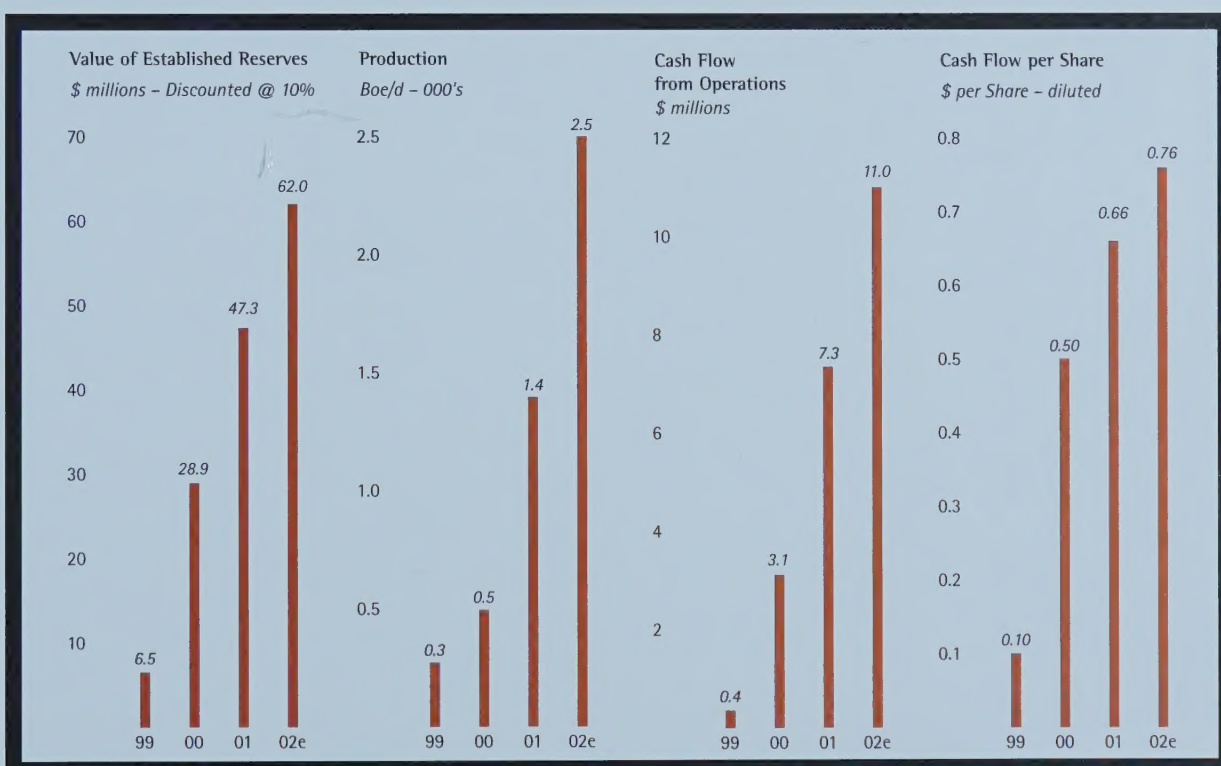
For the third straight year, Lexxor has posted record growth in production, reserves, undeveloped land and net asset value. This reflects the success of the growth strategies employed since early 1999 — strategies which have positioned Lexxor to continue to generate impressive returns for shareholders during 2002.

A Strategic Plan

Objectives

- Increase reserves & production in 3 core areas
- Increase cash flow & earnings
- Achieve rapid & sustained growth
- Increase share price

Performance

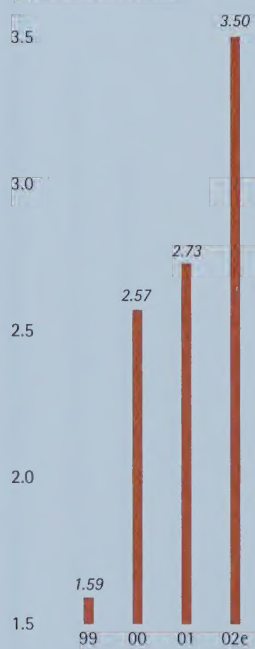


Implementation

- **Acquisitions** – Two substantial asset acquisitions totaling \$9.0 million in southeast Saskatchewan allowed Lexxor to take advantage of light oil opportunities.
- **Exploration** – During 2001, 7 (5.9 net) exploratory wells were drilled. In the first quarter of 2002, the Company participated in a new Dina oil pool discovery at Neutral Hills, south of Lexxor's original discovery in the fourth quarter of 2000.
- **Development** – Thirty six (20.7 net) development wells were drilled in 2001, of which 9.8 net were drilled at Neutral Hills.

FAST FACTS – LEXXOR ENERGY INC. – CDN: LXX

Net Asset Value per Share
\$ per Share – diluted



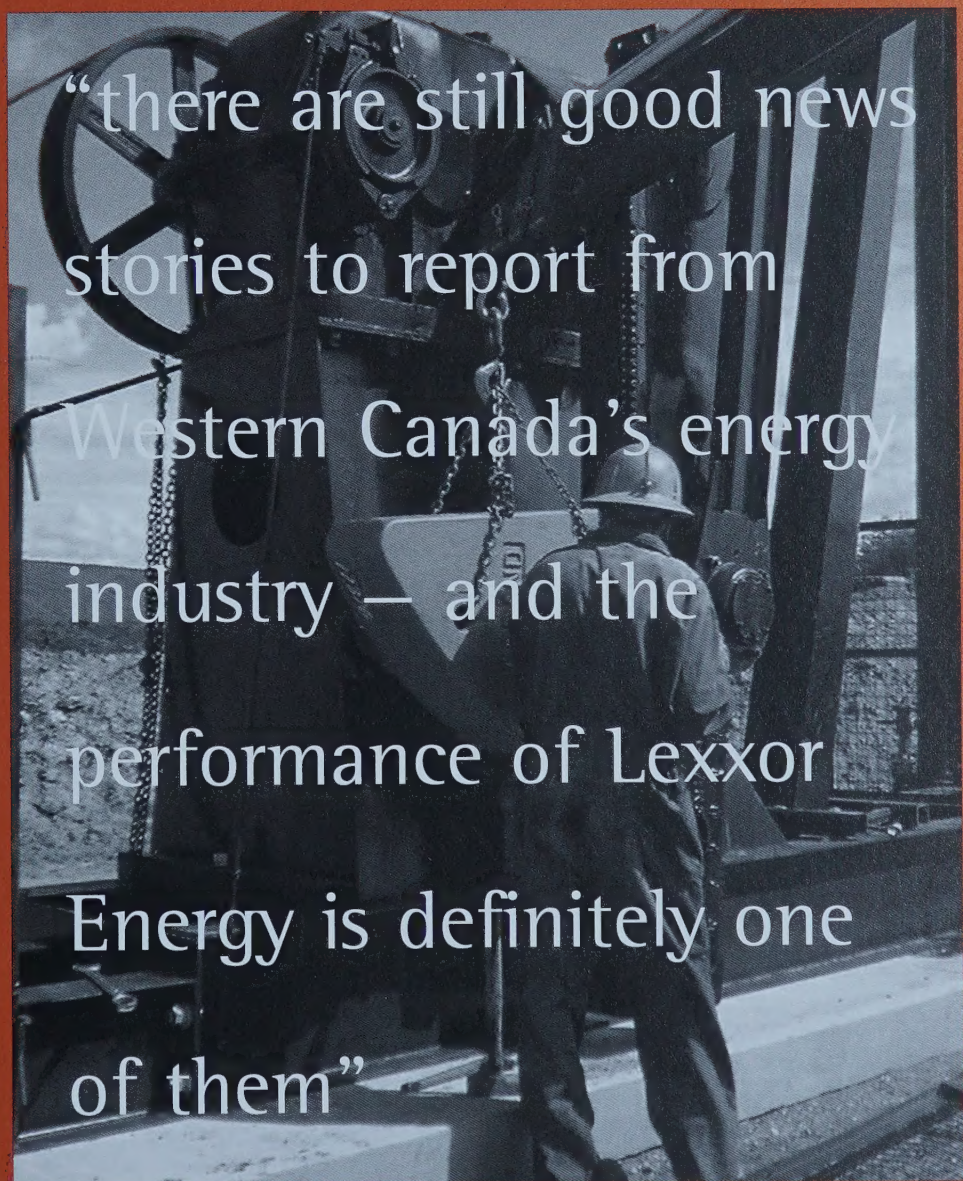
December 31 (000 except share amounts)		2001	2000	1999
Financial Results:				
Petroleum and natural gas sales	\$	16,362	\$ 6,632	\$ 1,807
Cash flow from operations	\$	7,345	\$ 3,110	\$ 357
Per share – diluted ⁽³⁾	\$	0.66	\$ 0.50	\$ 0.10
Net earnings	\$	1,807	\$ 1,340	\$ 15
Per share – diluted ⁽³⁾	\$	0.16	\$ 0.21	\$ 0.00
Net capital additions	\$	24,900	\$ 13,524	\$ 411
Debt and working capital deficiency	\$	16,466	\$ 4,638	\$ 1,623
Shareholders' equity	\$	17,321	\$ 10,191	\$ 1,045
Total assets	\$	46,476	\$ 21,095	\$ 3,875
Operating netback – (\$/Boe) ⁽¹⁾	\$	18.06	\$ 22.61	\$ 8.96
Common shares outstanding 14/3/02		13,400,093		
Shares issuable upon exercise of warrants		807,419		
Stock Options		1,306,000		
Operating Results: units as noted				
Production Oil and NGLs (Bbls/d)		1,065	211	79
Natural gas (Mcf/d)		1,983	1,696	1,151
Oil equivalent (Boe/d) ⁽¹⁾		1,395	494	271
Average selling price (\$/Boe)		32.24	37.01	18.26
Established reserves ⁽²⁾				
Oil and NGLs (MBbls)		3,767	1,654	631
Natural gas (MMcf)		6,539	5,993	3,203
Oil equivalent (MBoe) ⁽¹⁾		4,857	2,653	1,165
Present value of established reserves				
\$000 (discounted at 10% before tax)		47,259	28,911	6,530
Recycle ratio, established		1.5	2.1	4.7
Reserve replacement ratio, established		4.3	8.3	4.5
Reserve replacement costs (\$/Boe)		9.17	8.10	0.77
Reserve life index (years)		9.5	14.7	11.8
Wells drilled Gross		43.0	18.0	8.0
Net		26.6	10.5	3.7
Land holdings Gross acres		117,271	75,599	54,785
Net acres		64,422	30,066	19,218
Average working interest		62%	58%	46%

(1) Natural gas is equated to oil on the basis of 6 Mcf of natural gas = 1 barrel of oil equivalent (Boe)

(2) Established reserves are defined as proven reserves plus probable reserves risked at 50%. Proven reserves represent 97% of established reserves

(3) Consolidation (5:1) and re-designation of shares occurred on October 31, 2001. Information is re-stated.

2001 ANNUAL REPORT



“there are still good news stories to report from Western Canada’s energy industry – and the performance of Lexxor Energy is definitely one of them”

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LEXXOR ENERGY INC.

PRESIDENT'S REPORT TO THE SHAREHOLDERS

Despite a difficult end to 2001, there are still good news stories to report from Western Canada's energy industry — and the performance of Lexxor Energy Inc. is definitely one of them.

For the third straight year, our Company posted record growth in production, reserves, undeveloped land and net asset value in 2001. This reflects the success of the growth strategies we have employed since early 1999 - strategies which have positioned our Company to continue to generate impressive returns for shareholders during 2002.

Record Achievement

Success is reflected on the bottom line, and we're proud to point to Lexxor's record financial results in 2001. We increased petroleum and natural gas sales by 147 per cent to \$16.4 million from \$6.6 million in 2000; cash flow from operations by 136 per cent to \$7.3 million from \$3.1 million in 2000; and earnings by 35 per cent to \$1.8 million from \$1.3 million in 2000.

Our success was built on a solid foundation of growth. In 2001, we:

- Increased average daily production to 1,395 barrels of oil equivalent per day, compared to 494 in 2000 and 271 in 1999. Fourth quarter 2001 production averaged 2,002 barrels of oil equivalent per day, the eighth consecutive quarter of increased production.
- Increased established reserve volumes by 83 per cent after production to 4.9 million barrels of oil equivalent from 2.7 million in 2000, as determined by Chapman Petroleum Engineering Ltd. This growth replaced 2001's production by 4.3 times. Established reserve value (PV10 before tax) increased 64 per cent to \$47.3 million from \$28.9 million.
- Increased total net land holdings by 114 per cent (261 per cent increase in Saskatchewan holdings). Undeveloped lands totaling 47,730 net acres were valued at \$3.8 million in 2001, up from \$1.4 million in 2000, as determined by Seaton-Jordon & Associates Ltd.
- Increased net asset value by 36 per cent to \$39.1 million, compared to \$28.7 million in 2000 and \$6.4 million in 1999. This was accomplished despite a significant decrease in commodity prices during the year. We ended the year with a net asset value of \$2.73 per diluted share, up 6 per cent from \$2.57 per diluted share in 2000.

PRESIDENT'S REPORT TO THE SHAREHOLDERS

An Expanding Production Base

Lexxor's solid production base is comprised of approximately 2,000 barrels of oil equivalent per day with an 85 per cent light oil and a 15 per cent natural gas mix. This production is concentrated in three core areas: southeast Saskatchewan, east central Alberta and west central Alberta.

We achieved our 2001 production goal of 1,000 barrels of oil equivalent per day in both southeast Saskatchewan and east central Alberta. During 2002, exploration and development efforts will focus on maintaining and enhancing production levels in these two original areas and establishing gas production of 1,000 barrels of oil equivalent in our third core area of west central Alberta. Our exploration efforts during the first quarter of 2002 have already yielded some excellent results.

During 2001, Lexxor participated in 36 development wells and 7 exploratory wells for an overall success rate of 84 per cent. Lexxor was the operator of 40 of the 43 wells and maintained an average 62 per cent working interest. Twenty-one wells (9.8 net) were drilled at Neutral Hills in east central Alberta, developing our Dina oil discovery announced in the fourth quarter of 2000.

Investing in Growth

Capital additions, net of dispositions, of \$24.9 million exceeded our original 2001 capital budget of \$14 million. This increase allowed us to take advantage of light oil opportunities in southeast Saskatchewan. Two substantial asset acquisitions totaling \$9 million in this core area during 2001 gave our Company a meaningful presence. The acquisitions included reserves, production, drilling prospects, seismic data and a large undeveloped land base. We intend to capitalize on this strong position and the potential of these properties during the next two years.

During 2001, Lexxor reactivated six oil wells, drilled one vertical oil well, two horizontal re-entry oil wells and a significant horizontal oil well on the acquired properties. The horizontal oil well at Redvers started production at a rate of more than 1,000 barrels of oil per day. After experiencing normal declines, the well stabilized at a rate of 240 barrels of oil per day (215 barrels of oil per day net) in mid-January 2002, having produced more than 40,000 barrels of light crude oil. The well is expected to recover up to 300,000 barrels of crude oil during its producing life.

PRESIDENT'S REPORT TO THE SHAREHOLDERS

Market Realities

Our Company shared in the effects of lower energy prices and a downturn in the North American economy in the final quarter of 2001.

Our cash flow from operations of \$7.3 million in 2001 was lower than the forecast of \$12.3 million due to lower prices received for both oil and natural gas, and lower than forecasted production.

Posted prices for light sweet crude oil at Edmonton remained relatively stable during the first nine months of 2001 but dropped more than 25 per cent for the remaining three months of the year. Lexxor's average oil and natural gas liquids price for 2001 was \$32.37 per barrel, down from a forecasted \$37.65 per barrel. Natural gas prices decreased more dramatically and were off approximately 62 per cent in the fourth quarter from the first quarter of 2001. The Company's natural gas prices for 2001 averaged \$5.30 per thousand cubic feet, compared to the forecasted average price of \$7.00 per thousand cubic feet.

Our year-end debt and working capital deficiency of \$16.5 million was higher than the forecast of \$4 million and was a result of increased spending and lower cash flow. We expect to improve our debt to cash flow ratio during 2002 through the sale of non-core assets, modest amounts of debt repayment and a capital budget that does not exceed available cash flow.

Pursuing New Production Priorities

The downturn in the energy market also affected our average production rates, but opened up new potential for pursuing natural gas production in 2002.

Lexxor's average production rate of 1,395 barrels of oil equivalent per day was 18 per cent lower than its 2001 forecast average of 1,700 barrels of oil equivalent per day. This resulted from some production additions occurring later in the year than anticipated, and from declining gas deliverability. We briefly exceeded our 2001 exit target of 2,300 barrels of oil equivalent per day in October when the new horizontal well at Redvers came on stream, and ended the year at 2,000 barrels of oil equivalent per day.

During 2001, natural gas production declined from the first quarter average rate of 2,305 thousand cubic feet per day to 1,910 thousand cubic feet per day in the fourth quarter. In 2002, we anticipate a greater focus on natural gas as we pursue our production goal of 1,000 barrels of oil equivalent per day in west central Alberta.

PRESIDENT'S REPORT TO THE SHAREHOLDERS

With the onset of lower natural gas prices, less competitive pressures and other factors, we believe the current environment is more conducive to establishing a natural gas operating base in Alberta, west of the fifth meridian.

By increasing our exposure to natural gas, our overall average reserve life should increase and the Company will benefit from a strengthening price cycle for natural gas.

Reserve replacement costs in 2001 were higher than forecast, at \$9.17 per barrel of oil equivalent, \$1.07 higher than in 2000. Costs related to land purchases and geophysical activity at Neutral Hills, Alberta, and Antler, Saskatchewan, which positioned the Company for our first quarter 2002 drilling program were incurred in 2001. We expect considerably improved replacement costs for 2002.

Outlook for 2002

We have set our sights on further expanding production potential in 2002, particularly in natural gas.

Our 2002 capital budget has been set at \$11.5 million to drill 35 locations within our three core areas. Our targeted exit rate of 3,000 barrels of oil equivalent per day is expected to consist of 70 per cent light oil and 30 per cent natural gas, reflecting an increasing bias towards natural gas opportunities in Alberta.

In east central Alberta, the Company recently participated in a new Dina oil pool discovery at Neutral Hills. This pool, located to the south of our original discovery in the fourth quarter of 2000, is close to our new oil battery. Ample processing capacity at the battery will allow us to bring on higher oil production volumes at a very reasonable cost. We expect to take advantage of three-dimensional seismic interpretation to explore and develop the Neutral Hills area and maximize the return on our invested capital.

Our Company has also successfully drilled a new gas well in east central Alberta at Berry Creek and expects to place up to 1,500 thousand cubic feet per day (1,050 thousand cubic feet per day net) of new natural gas production on stream by the end of the first quarter of 2002.

In west central Alberta, the Company has reached a Farmout and Option Agreement involving 35 sections of land, a two-well drilling commitment and the right to drill option wells on a rolling basis in the Whitecourt area. We plan to

PRESIDENT'S REPORT TO THE SHAREHOLDERS


drill a minimum of two wells commencing in the first quarter of 2002, testing multi-zone gas potential. We continue to evaluate new acquisition and exploration opportunities in west central Alberta and expect to drill up to seven wells targeting natural gas during 2002.

In southeast Saskatchewan, Lexxor recently completed four three-dimensional seismic programs at West Antler, Parkman, Redvers and East Ingoldsby. We also purchased a three-dimensional survey at Wauchope. This seismic data will support an active exploration and development program targeting light crude oil. We intend to build on our recent drilling success in southeast Saskatchewan, drilling up to 16 wells – including five horizontal wells during 2002.

In 2002, we expect to generate cash flow from operations of \$11 million (\$0.76 per diluted share), based on average production rates of 2,500 barrels of oil equivalent per day; an average oil and natural gas liquids price of Cdn. \$26.87 per barrel; and natural gas averaging Cdn. \$3.25 per thousand cubic feet. Our exit target for the year has been set at 3,000 barrels of oil equivalent per day, a shift from our original goal of reaching that target by July 2002. We made the adjustment because less cash flow was available in a lower commodity price environment and because more time was needed to establish a position in west central Alberta.

Lexxor's full staff complement of 21 employees and three consultants are poised and ready to take our Company to an expanded production base over the next two years. We're focused, we're committed and we have talented people. Our success is a team effort.

We wish to express our appreciation to all of our employees, customers, business partners and shareholders for their continued support. We also wish to thank the Board of Directors for their guidance and advice to management during 2001.

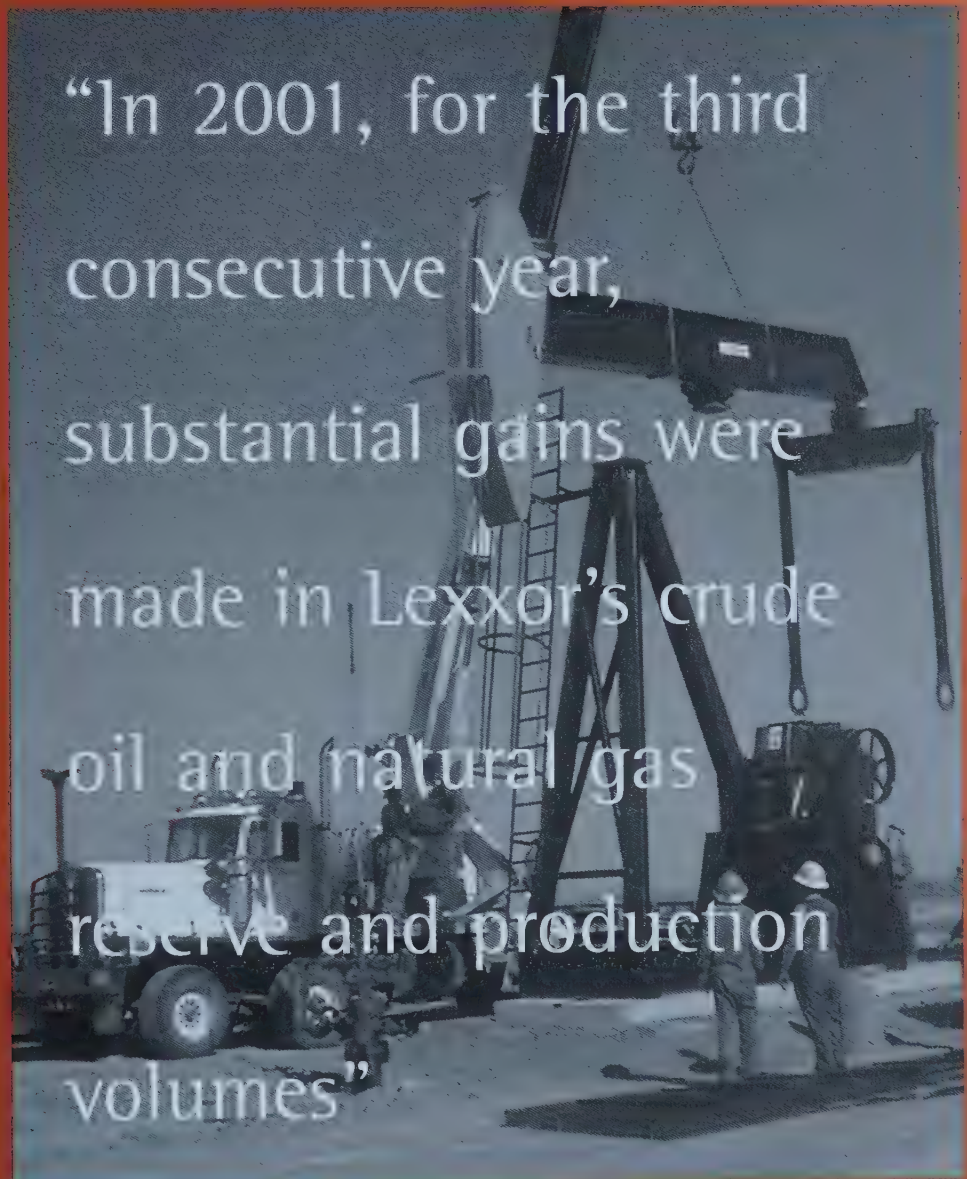


Douglas O. McNichol

President & Chief Operating Officer

March 19, 2002

REVIEW OF OPERATIONS



“In 2001, for the third consecutive year, substantial gains were made in Lexxor’s crude oil and natural gas reserve and production volumes”

3

LEXXOR ENERGY INC.

REVIEW OF OPERATIONS

Lexxor completed another successful year in 2001 with substantial gains in reserves and production for the third consecutive year. Established reserves (PV10 before tax) increased to \$47.3 million from \$28.9 million in the prior year and average production increased to 1,395 Boe/d from 494 Boe/d during 2000. Lexxor is on track to achieve its previously stated goal of developing three core areas, each producing approximately 1,000 Boe/d. During the fourth quarter of 2001, the two core areas of east central Alberta and southeast Saskatchewan produced the majority of Lexxor's average daily production of 2,002 Boe/d. The production mix for 2001 consisted of 76% oil and natural gas liquids and 24% natural gas.



Lexxor increased its total net land holdings by 114% (261% increase in Saskatchewan holdings). Undeveloped lands totalling 47,730 net acres were valued at \$3.8 million in 2001, up from \$1.4 million in 2000, as determined by Seaton-Jordon & Associates Ltd.

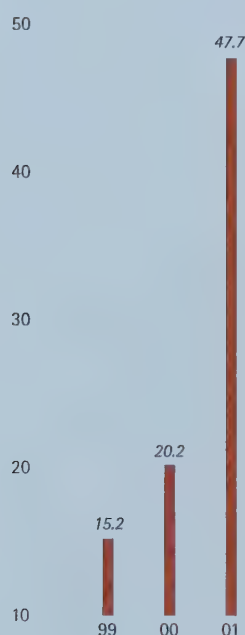
During 2002, exploration and development efforts will be directed towards maintaining and enhancing production levels in these two original areas at or above current levels, and to exit the year with 800 Boe/d of gas production in our third core area of west central Alberta. Lexxor has set its 2002 year-end production target at 3,000 Boe/d. Exit production for 2001 was 2,000 Boe/d, after reaching a production rate in excess of 2,300 Boe/d in October when a new prolific horizontal oil well at Redvers, Saskatchewan was placed on stream.

REVIEW OF OPERATIONS

The growth strategy applied by Lexxor includes asset acquisitions that have exploration and development potential and generation of new exploration prospects. This proven strategy resulted in the successful development of two areas, and continued adherence to the strategy will result in the successful development of a third, natural gas prone area in west central Alberta. As a result of the economic conditions in the market during 2001, Lexxor directed its financial resources towards light oil development. It is believed that with lower natural gas prices in 2002, there will be economic opportunities available as we establish a production base in this new natural gas prone area.

Land

Net Undeveloped Land
Acres – 000's



As of December 31, 2001, Lexxor held interests in a total of 117,271 gross (64,422 net) acres of land, 84,874 gross (47,730 net) of which was undeveloped, an increase of 114% over 2000 and 235% over 1999. Seaton-Jordan & Associates Ltd., ("Seaton-Jordan") an independent evaluation company, placed a value of \$3.8 million on Lexxor's undeveloped lands at December 31, 2001, compared to \$1.4 million as of December 31, 2000. Land values are determined by Seaton-Jordan using the most current prices paid at land sales for properties in the immediate vicinity of Lexxor's properties or where current prices are not available, using their best judgement. In addition, recognition is given to the remaining terms of the oil and gas leases as well as any particular burdens such as overriding royalties.

Lexxor's net land acreage in Saskatchewan increased by 261% from 2000 as a result of property acquisitions and other purchases of crown lands in the province. This does not include substantial undeveloped freehold lands in southeast Saskatchewan that Lexxor holds under an exclusive option for a remaining two year period from Talisman Energy Inc.

Land Holdings

By Area (acres)	Developed		Undeveloped		Total	
	Gross ⁽¹⁾	Net ⁽²⁾	Gross ⁽¹⁾	Net ⁽³⁾	Gross ⁽¹⁾	Net ⁽²⁾
December 31, 2001						
East central Alberta	17,440	9,116	26,364	16,240	43,804	25,356
West central Alberta	6,773	2,438	21,663	4,345	28,436	6,783
Southeast Saskatchewan	8,184	5,138	36,847	27,145	45,031	32,283
Total	32,397	16,692	84,874	47,730	117,271	64,422
December 31, 2000	23,613	9,916	51,986	20,150	75,599	30,066
December 31, 1999	11,849	4,066	42,936	15,152	54,785	19,218

(1) "Gross" refers to the total acres in which Lexxor has an interest

(2) "Net" refers to the total acres in which Lexxor has an interest, multiplied by the percentage working interest therein owned by Lexxor.

(3) The value of Lexxor's undeveloped land holdings were independently estimated at \$3.8 million by Seaton-Jordan & Associates Ltd.

REVIEW OF OPERATIONS

Drilling

Lexxor participated in the drilling of 43 (26.6 net) wells during 2001, of which 7 (5.9 net) were exploratory and 36 (20.7 net) were development wells. Lexxor was the operator of 40 of these wells. The drilling program, with average working interests of 62%, resulted in 32 (18.3 net) oil wells, 4 (2.8 net) gas wells, and 7 (5.5 net) dry holes, for an average success rate of 84%.

The following table shows the number of gross and net exploratory and development wells in which Lexxor has participated in drilling for the past three years. All wells were drilled in Alberta or Saskatchewan. Lexxor anticipates drilling up to 35 wells in 2002 at an average 50% working interest.

Year Ended December 31	2001		2000		1999	
	Gross ⁽¹⁾	Net ⁽²⁾	Gross ⁽¹⁾	Net ⁽²⁾	Gross ⁽¹⁾	Net ⁽²⁾
Oil	32	18.28	11	8.53	1	0.65
Gas	4	2.83	2	0.41	6	2.77
Dry	7	5.52	5	1.57	1	0.25
Total	43	26.63	18	10.51	8	3.67
Exploratory ⁽³⁾	7	5.89	11	5.33	6	2.54
Development ⁽⁴⁾	36	20.74	7	5.18	2	1.13
Total	43	26.63	18	10.51	8	3.67

(1) Gross wells means the number of wells in which Lexxor owns a working interest.

(2) Net wells means the aggregate of the percentage working interests of Lexxor in the Gross wells.

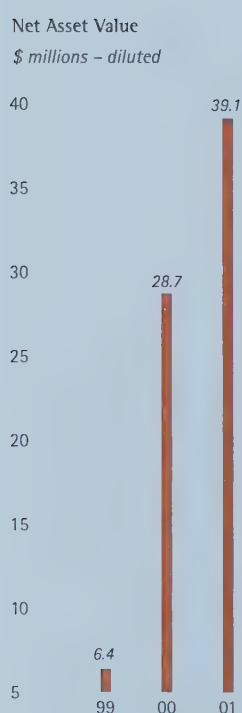
(3) An Exploratory well, in general, is a well drilled either in search of a new and as yet undiscovered pool of oil or natural gas, or with the expectation of significantly extending the limits of a pool which is partly delineated.

(4) A Development well, in general, is a well drilled within or in close proximity to a discovered pool of oil or natural gas.

Production

The Company's 2001 average production increased to 1,395 Boe/d, compared to 494 Boe/d in 2000 and 271 Boe/d in 1999. Lexxor has shown production increases for eight consecutive quarters as a result of acquisitions and drilling.

The production mix for 2001 consisted of 1,065 barrels per day of oil and natural gas liquids and 1,983 thousand cubic feet per day of natural gas (76% oil and NGLs and 24% natural gas).



REVIEW OF OPERATIONS

Production gains during 2001 were primarily attributable to drilling at Neutral Hills in Alberta and at Redvers, Ingoldsby, and Antler in Saskatchewan. Approximately 400 barrels per day of light oil production was acquired through two separate purchase transactions in southeast Saskatchewan in March and November, 2001.

Average Annual Production by Area

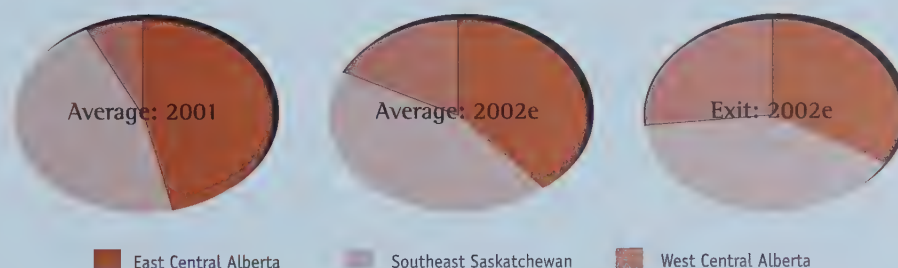
	Oil and NGLs (Bbl/d)	Natural Gas (Mcf/d)	Oil Equivalent Boe/d
December 31, 2001			
East central Alberta ⁽¹⁾	413	1,411	648
West central Alberta	13	516	99
Southeast Saskatchewan ⁽²⁾	639	56	648
Total	1,065	1,983	1,395
December 31, 2000	211	1,696	494
December 31, 1999	79	1,151	271

(1) 27% of total company production was derived from Lexxor's Neutral Hills Dina oil pool discovery.

(2) 17% of total company production was derived from Redvers, a property acquired and exploited in southeast Saskatchewan.

Production Growth

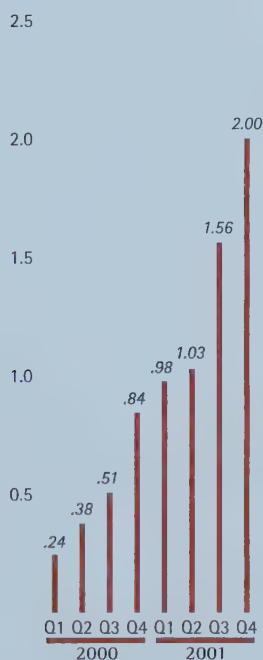
Boe/d



Reserves

Chapman Petroleum Engineering Ltd. ("Chapman"), an independent petroleum engineering firm, have performed a reserve and economic evaluation of the oil and gas properties owned by Lexxor in Alberta and Saskatchewan effective January 1, 2002. During 2001, Lexxor increased its total established reserves, after production, by 83% to 4,857 MBoe from 2,653 MBoe (6:1) in 2000. Proven plus probable reserves totaled 5,091 MBoe, up from 3,124 MBoe in 2000. This growth in reserves replaced 2001's annual production of 509 MBoe by 4.3 times (proven increase 4.8 times production).

Average Quarterly Production
Boe/d - 000



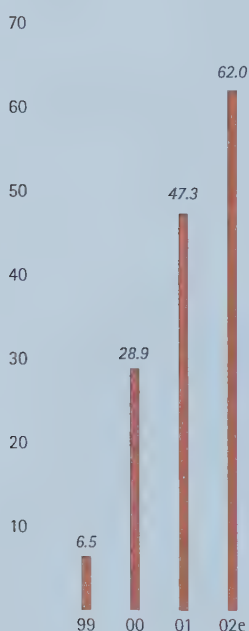
REVIEW OF OPERATIONS

The following table shows the distribution of reserves by commodity and their values.

Present Value of Reserves

Escalating Economics

Value of Established Reserves
\$ millions – Discounted @ 10%



	Reserves			Net to Appraised Interest			
	Oil MStb	Gas MMscf	NGL MBbls	Cumulative Cash Flow (BIT) M\$			
				Discounted at			
January 1, 2002				Undisc.	10%/yr	15%/yr	20%/yr
Proven producing	2,665	3,573	44	53,293	34,189	29,578	26,275
Proven non-producing							
(developed)	4	2,280	53	7,344	3,741	3,032	2,581
Total proven (developed)	2,669	5,853	97	60,637	37,930	32,610	28,856
Total proven non-producing							
(undeveloped)	826	338	0	11,301	7,927	6,988	6,286
Total proven	3,495	6,191	97	71,938	45,857	39,598	35,142
Probable	351	696	0	5,901	2,803	2,116	1,655
Proven plus probable	3,846	6,887	97	77,839	48,660	41,714	36,797
Less 50% probable	176	348	0	2,951	1,401	1,058	827
Proven plus 50% probable	3,670	6,539	97	74,888	47,259	40,656	35,970

In the determination of reserve values, Chapman independently prepares oil, gas and by-product price forecasts based on historical data, current conditions, and their view of the relevant political and economic trends. The present value of Lexxor's established reserves, discounted at 10% before tax, increased 64% to \$47.3 million from \$28.9 million at the end of 2000. **Lexxor's proven reserve value of \$45.9 million, discounted at 10% before tax, represents 97% of its total established values.**

Higher values for increased reserve volumes were offset by lower forecasted product pricing (average 2002 forecast prices were down 21% for oil and 12% for natural gas versus last year's evaluation). The following wellhead product prices were used in the 2001 reserve evaluations:

Pricing Forecast

	Crude oil \$/Stb	Natural gas \$/Mcf
2002	27.14	3.51
2003	30.83	3.77
2004	32.78	4.03
2005	34.77	4.02
2006	36.04	4.13

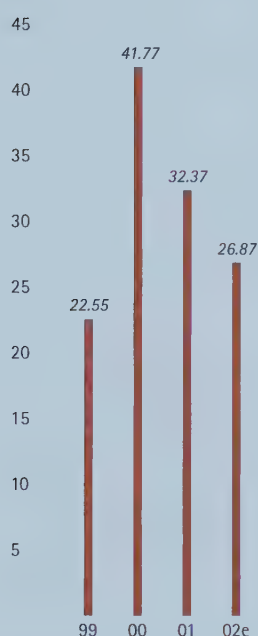
REVIEW OF OPERATIONS

Changes in reserves during the past three years are outlined in the following table.

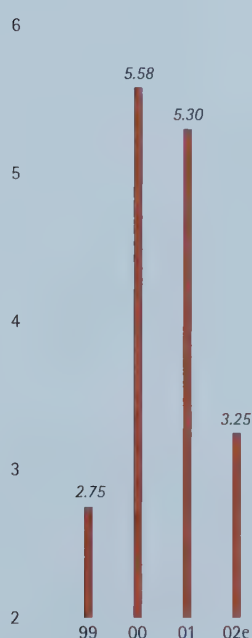
Reserve Continuity Summary

	Natural Gas (MMcf)		NGLs (MBbls)		Crude Oil (MBbls)		Boe (6:1) (MBoe)	
	Prov.	Prob.	Prov.	Prob.	Prov.	Prob.	Prov.	Prob.
December 31, 1998	1,728	38	14.1	0.5	386.3	41.3	688.2	48.1
Discoveries/extensions	1,903	263	33.1	0.7	106.9	185.1	457.1	229.6
Acquisitions/divestitures	(342)	(140)	19.8	0.0	0.0	(16.8)	(37.2)	(40.1)
Production	(420)	0	(3.7)	0.0	(25.2)	0.0	(98.9)	0.0
Revisions	142	223	2.6	1.1	(32.7)	47.9	(6.4)	86.2
December 31, 1999	3,011	384	65.9	2.3	435.3	257.5	1,002.8	323.8
Discoveries/extensions	429	0	0.0	0.0	677.8	375.0	749.3	375.0
Acquisitions/divestitures	2,142	93	65.1	6.0	507.5	493.0	929.7	514.5
Production	(619)	0	(3.2)	0.0	(73.9)	0.0	(180.3)	0.0
Revisions	682	219	(48.6)	(8.3)	(385.2)	(298.5)	(320.1)	(270.3)
December 31, 2000	5,645	696	79.2	0.0	1,161.5	827.0	2,181.4	943.0
Discoveries/extensions	2,344	0	61.0	0.0	1,285.0	72.0	1,736.7	72.0
Acquisitions/divestitures	(235)	0	(18.0)	0.0	1,475.0	0.0	1,417.8	0.0
Production	(724)	0	(4.0)	0.0	(384.7)	0.0	(509.3)	0.0
Revisions	(839)	0	(21.2)	0.0	(41.8)	(548.0)	(201.8)	(548.0)
December 31, 2001	6,191	696	97.0	0.0	3,495.0	351.0	4,623.8	467.0

Crude Oil Sales Price
\$/Bbl



Natural Gas Sales Price
\$/Mcf



Lexxor was successful in adding oil reserves in 2001 through drilling at Neutral Hills in Alberta and at Redvers, Ingoldsby and Antler in Saskatchewan. Significant amounts of oil reserves were acquired through two separate purchase transactions in southeast Saskatchewan. Natural gas reserves were added mainly through exploration and development efforts at Wilson Creek, Neutral Hills and Nisku, Alberta. A large portion of Lexxor's oil reserves previously carried as probable reserves were reclassified as proven reserves as a result of drilling activities at Neutral Hills, Alberta. Natural gas reserves were reduced at Taber and Provost, Alberta as a result of poorer than expected production performance. Lexxor's volumes of established reserves have increased by 582% after production during the three-year period ended December 31, 2001.

REVIEW OF OPERATIONS

Reserve Summary and Reserve Life Index

For the years ended December 31	2001	2000	1999
Oil equivalent (6:1)			
Proven producing reserves (MBoe)	3,305	1,648	524
Proven non-producing reserves (MBoe)	1,319	533	479
Total proven reserves (MBoe)	4,624	2,181	1,003
Annual production (MBoe)	509.3	180.3	98.9
Proven reserve life index (years)	9.1	12.1	10.1
Established reserves (MBoe)	4,857	2,653	1,165
Annual production (MBoe)	509	180	99
Established reserve life index (years)	9.5	14.7	11.8

Capital Additions and Reserve Replacement Costs

For the years ended December 31 (\$000)	2001	2000	1999
Lease rentals and acquisition	1,349	94	119
Geological and geophysical expenditures	1,148	163	(85)
Drilling and completions	8,388	3,010	1,229
Equipment and facilities	4,592	1,843	504
Acquisitions/divestitures (net)	7,724	8,010	(1,792)
Capitalized G&A and other costs	1,699	404	436
Total net capital additions	24,900	13,524	411
Net change in established reserves			
after production (MBoe)	2,206	1,488	453
Annual production (MBoe)	509	180	99
Annual reserve additions (MBoe)	2,715	1,668	552
Annual acquisition, finding and development costs (\$/Boe) ⁽¹⁾	9.17	8.10	0.77

(1) 1999 replacement costs were extremely low as a result of property divestitures

Reserve replacement costs at \$9.17/Boe were higher than forecast and \$1.07/Boe higher than 2000. Some of the additional costs related to year-end 2001 purchases of land and geophysical data at Neutral Hills, Alberta and Antler, Saskatchewan, positioning the Company for its first quarter 2002 drilling program. Lexxor expects to report considerably improved replacement costs for 2002.

Recycle Ratio for Established Reserves

For the years ended December 31	2001	2000	1999
Oil equivalent (6:1)			
Cash netback (\$/Boe)	13.94	16.83	3.61
Established reserve replacement cost (\$/Boe)	9.17	8.10	0.77
Recycle ratio	1.5	2.1	4.7

REVIEW OF OPERATIONS

PROPERTY REPORTS

Southeast Saskatchewan

As at December 31	2001	2000	1999
Net acres of land			
Developed	5,138	1,977	419
Undeveloped	27,145	6,957	2,358
Total (1)	32,283	8,934	2,777
Average Daily Production			
Crude oil & NGLs (Bbl/d)	639	129	24
Natural gas (Mcf/d)	56	-	-
Total Boe/d (6:1)	648	129	24
Established Reserves			
Crude oil and NGLs (MStb)	2,941	862	36
Natural gas (Mmscf)	906	195	-
Total MBoe	3,090	895	36
Value of Established Reserves (10% PV) \$000			
Proven	29,700	10,251	206
Probable (risked @ 50%)	560	1,617	16
Total	30,260	11,868	222

(1) This does not include substantial undeveloped freehold lands in southeast Saskatchewan that Lexxor holds under exclusive option from Talisman Energy Inc.

Highlights of Area

- Area of minimal competition
- Acquisitions available at low prices
- 3D seismic defines structure and lowers risk
- Oil production, highly developed infrastructure
- Low risk drilling

2001 Activities

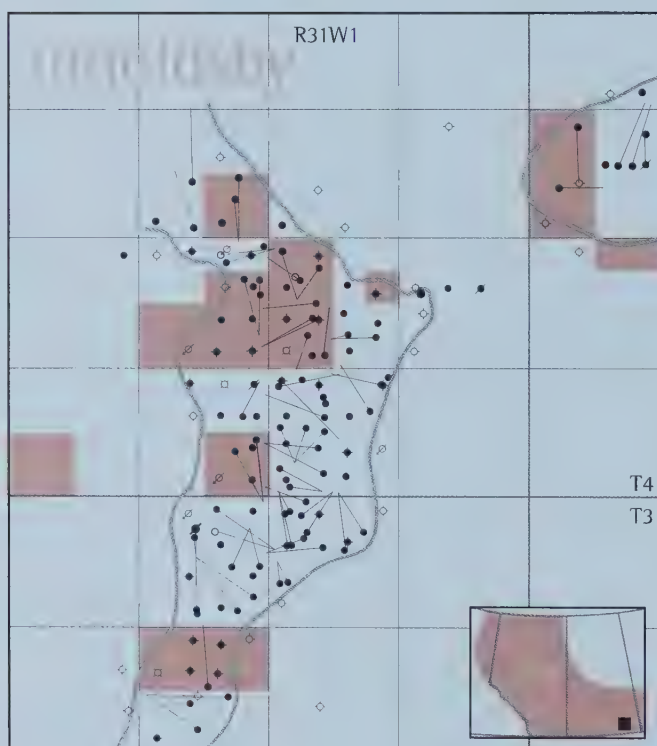
- Two significant acquisitions totaling \$9 million
- Drilled 10 wells
- Reactivated 6 wells
- Acquisitions added 1,430,000 barrels of light oil reserves
- Development added 878,000 barrels of light oil reserves
- Increased production from 24 Boe/d in 1999 to 1,000 Boe/d at year end 2001

2002 Activities

- Drill 16 wells
- Conduct four 3D seismic surveys
- Purchase one 3D seismic survey
- Maintain 1,200 Boe/d production

REVIEW OF OPERATIONS

Exit production from southeast Saskatchewan on December 31, 2001 was approximately 1,000 Boe/d, of which 97% was light oil production. The reserves in southeast Saskatchewan currently have an 8.5 year reserve life index (based on a 1,000 Boe/d rate). High producing water cuts require facilities for water disposal. The majority of Lexxor's production is tied into central processing facilities resulting in lower overall operating costs. During 2002, Lexxor intends to maintain an average 1,200 barrels per day of production in this area through the drilling of approximately 16 wells. The success of this core area is attributable to adherence to Lexxor's corporate strategy of aggressively targeting acquisitions of underdeveloped assets and continued exploitation.



In 1996, Lexxor participated in a successful 150 Bbl/d horizontal well at **Ingoldsby** and followed this with another successful dual leg horizontal well in mid-1997. The well exceeded expectations, coming on stream at 240 Bbl/d. The corporate drilling programs during 1998 and 1999 were focused in Alberta and no activity occurred in southeast Saskatchewan during this period.

The acquisition of Icon Energy Limited effective April 3, 2000 included a 65% working interest in 4,640 acres of land at **Antler**, including 9 (5.9 net) producing oil wells, 10 (6.5 net) shut-in oil wells, a battery, a water disposal well, and extensive 3D seismic over nine sections of land. The property was producing approximately 55 Boe/d of production and had proven reserves of 392 MStb. Of particular interest to Lexxor were the

considerable opportunities for increased value through reactivations and the re-processing of a three-dimensional seismic survey, identifying five separate structurally-closed Mississippian features. At Antler, five oil wells were reactivated and flowlined to a central battery. Additional water handling and disposal facilities were installed to increase overall capacity for future drilling. In December 2000, Lexxor acquired DBM Energy Inc., increasing Lexxor's working interests at Antler to 95%. Exit production at Antler on December 31, 2001 was 115 Bbls/d of light oil. During 2002, Lexxor intends to drill three wells to test new structures identified by a 17 square mile three-dimensional seismic survey conducted in the fourth quarter of 2001.

REVIEW OF OPERATIONS

In proximity to the Antler property, Lexxor completed a significant \$4 million acquisition of properties at **Redvers**, Edenvale, and Ingoldsby from Talisman Energy Inc. in March 2001. The acquisition included 200 Bbls/d of light oil and upside potential at Redvers, Parkman and Ingoldsby. The acquisition also included an exclusive three-year option on substantial acres of undeveloped freehold lands. During 2001, Lexxor reactivated six oil wells and drilled one horizontal oil well and one vertical well, resulting in a further increase of approximately 230 net barrels per day of light oil production.

In the fourth quarter 2001, Lexxor drilled a significant horizontal well at Redvers that produced over 1,000 barrels per day of light oil during an initial 4 day period. After experiencing normal declines, the well stabilized at a rate of 240 Bbl/d (215 Bbl/d net) in mid-January 2002, having produced more than 40,000

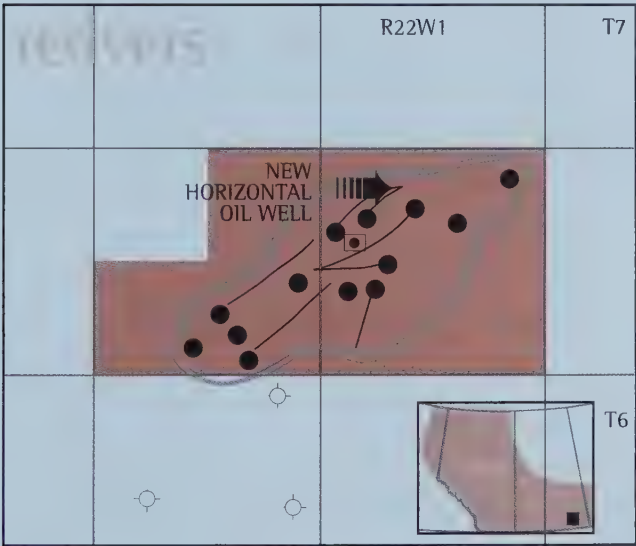
barrels of light crude oil. The well is expected to recover up to 300,000 barrels of crude oil during its producing life.

A small acquisition was made in October 2000 that included reserves and production at Ingoldsby. Following this acquisition Lexxor upgraded the 50% owned oil battery and drilled a horizontal re-entry oil well. In November 2001, Lexxor closed another acquisition of producing properties in the Ingoldsby area for \$5 million. This acquisition included six producing horizontal oil wells, minor interests in a further three oil wells, 10,000 acres of undeveloped land, and 4 square miles of proprietary seismic data.

Prior to year-end, Lexxor successfully drilled a

second horizontal re-entry oil well. Exit production at Ingoldsby on December 31, 2001 was 305 Bbls/d of light oil, up from 30 Bbl/d in January 2001. Lexxor’s 2002 capital budget includes a minimum of one workover and four horizontal re-entries in order to maximize the value of this property.

At year end 2001, 40% of the total production in southeast Saskatchewan was at Redvers, 30% was in Ingoldsby, 10% in Edenvale, and 10% in Antler. Lexxor is continuing to pursue upside opportunities on the lands acquired throughout 2001. Exploration and development plans during 2002 include recently completed three-dimensional seismic surveys at Redvers, West Antler, Ingoldsby East and Parkman and an active drilling program.



REVIEW OF OPERATIONS

East Central Alberta

As at December 31	2001	2000	1999
Net acres of land			
Developed	9,116	6,175	3,391
Undeveloped	16,240	8,643	8,008
Total	25,356	14,818	11,399
Average Daily Production			
Crude oil & NGLs (Bbl/d)	413	64	34
Natural gas (Mcf/d)	1,411	852	869
Total Boe/d (6:1)	648	206	179
Established Reserves			
Crude oil and NGLs (MStb)	746	743	378
Natural gas (MMscf)	2,438	3,299	2,415
Total MBoe	1,152	1,293	780
Value of Established Reserves (10% PV) \$000			
Proven	11,255	9,703	3,098
Probable (risked @ 50%)	806	2,757	218
Total	12,061	12,460	3,316

Highlights of Area

- Area of reduced competition
- Crown land available at low prices
- High density of original seismic data
- Oil production, highly developed infrastructure
- Short reserve life index

2001 Activities

- Drilled 31 wells, including 21 development wells in Dina pool at Neutral Hills
- Development program added 421,000 barrels of proven light oil reserves
- Increased production from 250 Bbl/d to 700 Bbl/d at Neutral Hills
- New oil battery
- Conducted large 3D seismic program

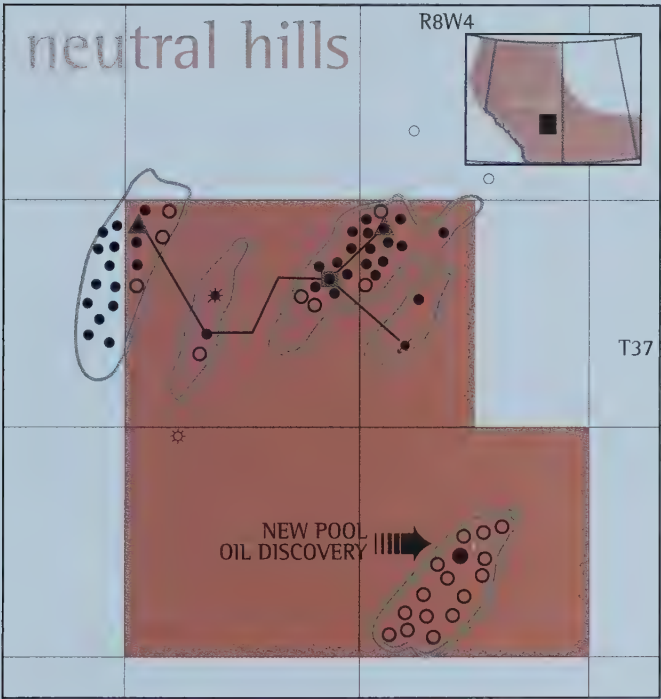
2002 Activities

- Drill 12 wells
- Develop new pool discovered south of Neutral Hills property in Q1 2002
- Maintain 1,000 Boe/d production

Exit production for east central Alberta on December 31, 2001 was approximately 900 Boe/d, of which 77% was light oil derived from Lexxor's Neutral Hills property. The success of this property is attributable to Lexxor's ability to perform full cycle exploration and development.

REVIEW OF OPERATIONS

The exploration cycle at **Neutral Hills** was initiated when Lexxor entered into a Farmout and Option Agreement in the fourth quarter of 2000. The Farmout and Option Agreement encompassed 3,000 acres, where Lexxor would drill to earn interests in the land. Using the available three-dimensional seismic data, Lexxor discovered a new Dina oil pool in the Neutral Hills area.



Using three-dimensional seismic over the discovery, development well locations were selected and proven to be accurate. Throughout 2001, Lexxor drilled 21 development wells (9.8 net) spending \$6 million, resulting in \$9.2 million of proven reserve value (10% PV) at year-end. For the year ended December 31, 2001, this property produced 139,958 Boe and generated \$4.5 million of petroleum and natural gas sales, representing 27% of total company volume and sales. Lexxor has 3,468 net acres of undeveloped land in Neutral Hills.

As a result of the success at Neutral Hills, Lexxor and its partner recently completed the construction of a permanent oil processing facility on the property.

Lexxor recently participated in an oil pool discovery south of the original Dina oil pool at Neutral Hills using a three-dimensional seismic survey conducted in the fourth quarter of 2001. Lexxor holds a 50% working interest in this new Dina oil pool. During 2002, Lexxor intends to participate in the development of this new pool, located near its oil battery. Lexxor intends to maintain and enhance production in the east central Alberta core area through the drilling of approximately 12 wells. In order to minimize geological risk, three-dimensional seismic will be used to assist in selecting further well locations. Lexxor intends to pursue a small number of crown land sales, where land is available with a minimum of competition.

An area of reduced competition, the east central Alberta core area has available lands for purchase and a high density of original seismic data. The area has a short reserve life index. Water associated with oil production requires disposal and water in gas reservoirs reduces recoveries. However, the exploration efforts demonstrated to date in this exploration driven core area continue to offer economic parameters for continued development.

REVIEW OF OPERATIONS

West Central Alberta

As at December 31	2001	2000	1999
Net acres of land			
Developed	2,438	1,307	256
Undeveloped	4,345	4,550	3,442
Total	6,783	5,857	3,698
Average Daily Production			
Crude oil & NGLs (Bbl/d)	13	5	0
Natural gas (Mcf/d)	516	663	26
Total Boe (6:1)	99	116	5
Established Reserves			
Crude oil and NGLs (MStb)	82	49	218
Natural gas (MMscf)	3,196	2,499	788
Total MBoe	615	466	349
Value of Established Reserves (10% PV) \$000			
Proven	4,344	3,246	244
Probable (risked @ 50%)	31	34	0
Total	4,375	3,280	244

Highlights of Area

- Existing gas infrastructure
- Area of intense competition - land sale prices are now dropping and contiguous land blocks are appearing
- Long life reserves
- Moderate depths less than 2,000 metres
- Low to moderate risk profiles
- Almost year round access

2001 Activities

- Drilled 1 development well at Wilson Creek
- Drilled and abandoned 1 exploratory well at Bigoray
- Entered into a Farmout and Option Agreement with the right to drill option wells at Whitecourt
- Deferred 2001 program awaiting more favourable conditions

2002 Activities

- Drill 7 wells
- Tie in gas well at Wilson Creek at 300 Mcf/d net, 100% W.I.)
- Acquire trade seismic data
- Post specific crown sale lands
- Joint venture drilling and farm-ins
- Increase production to 800 Boe/d, primarily natural gas by year end

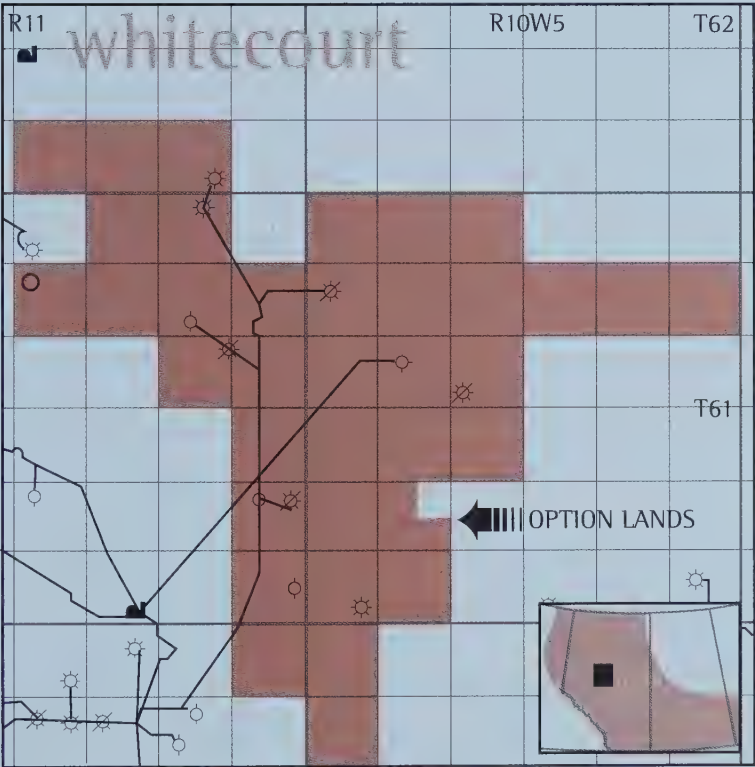
REVIEW OF OPERATIONS

Exit production for west central Alberta on December 31, 2001 was approximately 442 Mcf/d of natural gas and 11 Bbls/d of crude oil and natural gas liquids, primarily from Lexxor’s properties at **Nisku** and **Garrington**. Production has increased since year end with a new well at **Wilson Creek** placed on production in February 2002 at 300 Mcf/d.

Intense competition in the marketplace resulting from high natural gas prices curtailed Lexxor’s exploration and acquisition efforts for natural gas during 2001. Only one gas well was drilled in west central Alberta at Wilson Creek in 2001.

During the past six months, Lexxor has seen contiguous land blocks appearing and land sale prices have been reduced. The west central area offers multi-zone, liquid rich gas targets, at moderate depths. Reserves are long life and facilities are numerous and under utilized.

In December 2001, Lexxor entered into a Farmout and Option Agreement. This Farmout and Option Agreement is a prime example of Lexxor’s thrust into a deeper, gas prone region of the Alberta basin. This venture encompasses 35 sections of contiguous land at **Whitecourt** and initially commits Lexxor to drill two 1,500 meter exploratory wells targeting multi-zone gas potential



already well established in this area. Prospective zones include the Pekisko, Nordegg, Ellerslie, Ostracod, Notikewin, and Viking formations. Gas gathering facilities exist on these option lands and processing facilities with available capacity are in close proximity. Drilling is planned to commence in March, prior to spring break-up. Additional drilling and gas gathering operations are scheduled to continue on a rolling basis as success dictates. Lexxor is the operator and will maintain a majority interest in all wells.

ENVIRONMENT AND SAFETY

Summary

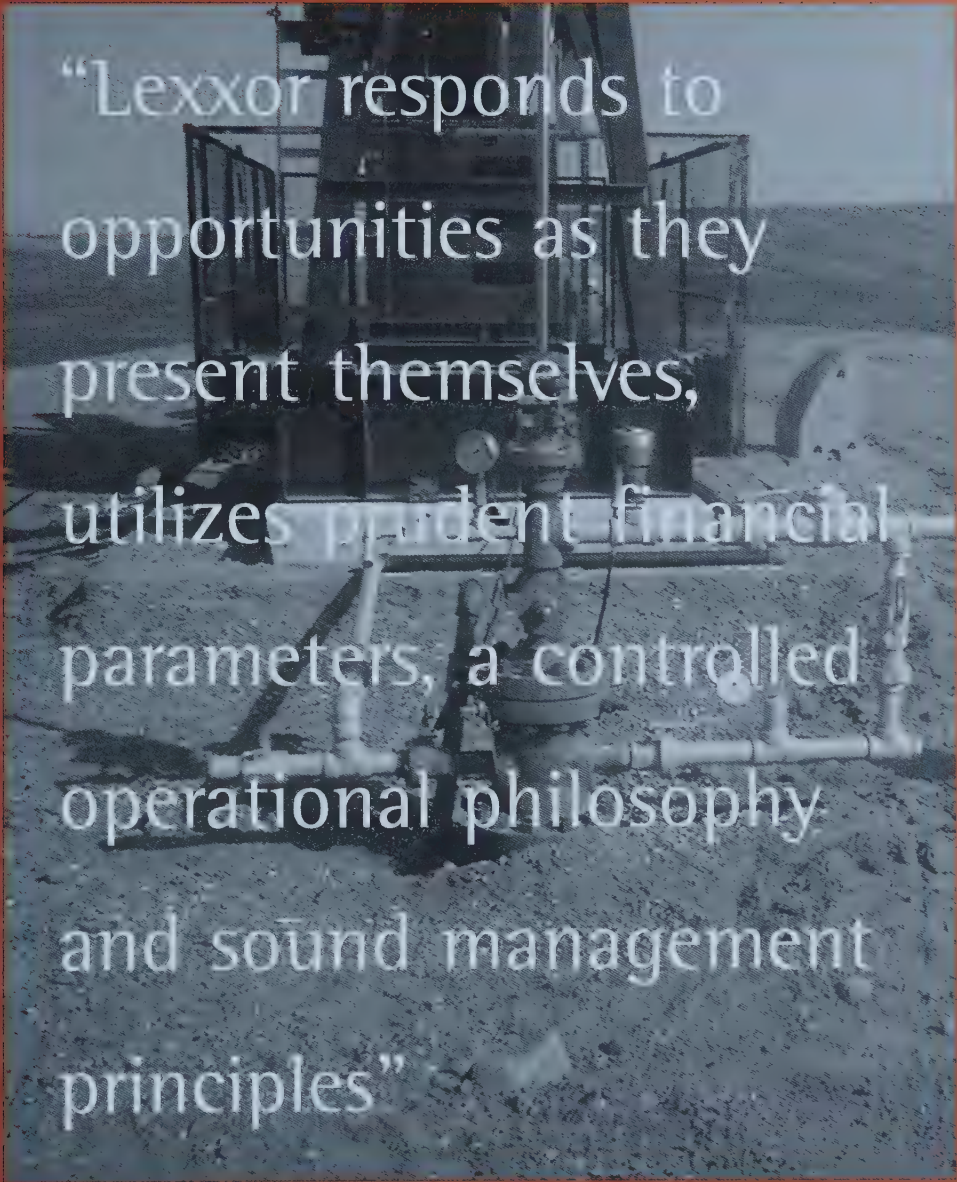
Lexxor Energy Inc. is committed to safeguarding human health and protecting the environment in all its operations and endeavours. This is a management responsibility, as well as the responsibility of every employee and contractor performing their duties on behalf of Lexxor.

Exemplary performance in the areas of health, safety, and the environment is essential in fulfilling Lexxor's business goals, enhancing shareholder value, and meeting the needs and expectations of the stakeholders. To achieve this, Lexxor integrates health, safety, and environmental considerations into all decisions affecting the operations of the Company. The policies, systems, and procedures are reviewed periodically for improvements.

To support this integration, Lexxor personnel and contractors are guided by the following principles:

- Compliance with all applicable legal, regulatory, industry and corporate standards;
- Planning projects and activities to anticipate safety and environmental problems and implement measures for the prevention and/or the reduction of adverse effects;
- Ensuring timely and effective response and follow-up to incidents resulting from operations. Lexxor's Emergency Response Plan is regularly updated to ensure accuracy of contact information and other essential services;
- Ensuring employees and contractors are properly trained, understand and accept responsibility to operate in a manner consistent with Lexxor's safety and environmental policies;
- Remain sensitive to the concerns of the public.

FINANCIAL REVIEW



“Lexxor responds to opportunities as they present themselves, utilizes prudent financial parameters, a controlled operational philosophy and sound management principles”

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LEXXOR ENERGY INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Management's Discussion and Analysis focuses on information contained in the Financial Statements and the related notes. This discussion should not be considered all-inclusive, as it excludes changes that may occur in general economic, political and environmental conditions. Additionally, other elements may or may not occur which could affect the Company in the future. In order to obtain the best overall perspective, this discussion should be read in conjunction with the material contained in other parts of this annual report.

Lexxor continued the trend of strong growth and profitability commenced in 1999 into 2001. With a solid base built from corporate acquisitions, Lexxor combined select property acquisitions with successful development and exploratory drilling activities producing quarter over quarter increases in production, enabling Lexxor once again to produce record revenue, cash flow and earnings in 2001. Our aggressive growth story, that responds to opportunities as they present themselves, utilizes prudent financial parameters, a controlled operational philosophy and sound management principles.

Lexxor commenced the year focused on developing, exploiting and optimizing properties acquired and pools discovered over the last two years. These strategies led to an aggressive development program in our Neutral Hills, Alberta area and an opportunity to make two significant property acquisitions in our core area of southeast Saskatchewan. These initiatives solidified Lexxor's position in these two core areas. Our development and extension of an oil pool in Neutral Hills led to the drilling of 21 gross wells (9.8 net) and the expenditure of approximately \$6.0 million. Production at Neutral Hills increased from an average of 41 Boe/d in 2000 to 383 Boe/d in 2001. Property acquired in southeast Saskatchewan at a cost of \$9.0 million increased production by approximately 400 Boe/d. Successful development and exploration on lands acquired as part of this transaction should produce additional increases in production during 2002.

Net Asset Value

Lexxor's net asset value increased by 36% during 2001 as a result of higher values for its proven and probable reserves, undeveloped land, and seismic. This was achieved notwithstanding a significant decrease in commodity prices. On a diluted basis, net asset value increased from \$2.57 per share to \$2.73 per share or approximately 6%. The number of basic shares increased by approximately 36% resulting from new equity issued on a flow-through basis and the exercise of warrants in June 2001. These warrants were issued to the shareholders of Icon Energy Limited in April 2000 when Lexxor acquired the company.

MANAGEMENT'S DISCUSSION AND ANALYSIS

For the years ended December 31	2001	2000	1999
Oil and gas reserves (\$M) ⁽¹⁾			
Proven reserves	45,857	24,306	5,414
Risked probable reserves	1,401	4,606	1,116
Gross overriding royalties ⁽²⁾	360	450	0
	47,618	29,362	6,530
Land & seismic (\$M)			
Undeveloped land	3,809	1,392	1,078
Seismic	2,534	600	420
	6,343	1,992	1,498
Working capital deficit and long term debt (\$M)	(16,466)	(4,638)	(1,623)
Net asset value - basic (\$M)	37,495	26,716	6,405
Basic shares outstanding (000)	13,400	9,874	4,022
Net asset value per share - basic	\$ 2.80	\$ 2.71	\$ 1.59
Exercise of convertible securities (\$M) ⁽³⁾⁽⁴⁾	1,611	2,004	0
Net asset value - diluted (\$M)	39,106	28,720	6,405
Diluted shares outstanding (000) ⁽³⁾⁽⁴⁾	14,359	11,180	4,022
Net asset value per share - diluted	\$ 2.73	\$ 2.57	1.59

(1) Proven and risked probable reserves (50% risk) discounted at 10% before tax.

(2) Gross overriding royalties include royalty acquired with Icon Energy Limited and miscellaneous royalties in southeast Saskatchewan acquired from Talisman. Values estimated internally by management.

(3) Assumes 959,000 stock options issued as at December 31, 2001 are exercised at an average price of \$1.68 per share.

(4) Warrants outstanding to purchase 807,419 Common shares exercisable at \$3.00 until June 30, 2002 have not been included in the diluted calculation.

Production (gas converted to a barrel of oil equivalent at a conversion rate of 6:1)

Production (sales) for the year increased on a barrel of oil equivalent basis 183% to average 1,395 Boe/d versus 494 Boe/d in 2000. Lexxor's production mix consisted of 1,983 Mcf/d of natural gas (24% of total), and 1,065 Bbls/d of oil and NGLs, (76% of total).

Lexxor was successful in 2001 in establishing a solid production base in two of its core areas. Production in each of these two core areas is now averaging approximately 1,000 Boe/d. Our production goals for 2002 are to establish a third core area in west central Alberta (west of 5th meridian), average 2,500 Boe/d for the year and exit 2002 at approximately 3,000 Boe/d.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Production by Area

(Boe)	2001		2000		1999	
	Volume	% of Total	Volume	% of Total	Volume	% of Total
Neutral Hills	139,958	27	14,798	8	0	0
Redvers	84,556	17	0	0	0	0
Antler	65,105	13	37,517	21	0	0
Ingoldsby	44,831	9	9,390	5	8,866	9
Antelope	34,475	7	14,710	8	5,064	5
Edenvale	28,203	6	0	0	0	0
Monitor	25,326	5	34,717	19	47,482	48
Nisku	18,694	4	30,090	17	0	0
Court	13,425	2	5,258	3	12,862	13
Taber	11,129	2	0	0	0	0
Minor properties	43,630	8	33,782	19	24,652	25
Total	509,332	100	180,262	100	98,926	100

Average Prices

The average price received per barrel of oil equivalent in 2001 decreased to \$32.24 per Boe down 13% from \$37.01 per Boe received in 2000. The average natural gas price decreased 5% in 2001, down from \$5.58 per Mcf in 2000 to \$5.30 per Mcf in 2001. Management expects further price weakening for natural gas and is forecasting natural gas to average approximately \$3.25 per Mcf in 2002. The average price received for oil and NGLs decreased 23% in 2001 to average \$32.37 per Bbl versus \$41.77 per Bbl in 2000. A further decline in oil prices is expected in 2002 with WTI expected to average approximately \$20.00 US per barrel. Lexxor's oil and NGLs price is assumed to average slightly less than Cdn. \$27.00 per Bbl.

Commodity Prices

	2001	2000	1999
Oil and NGLs (barrels)	388,692	77,116	28,835
Natural gas production (Mcf)	723,840	618,876	420,546
Barrels of oil equivalent (Boe) 6:1	509,332	180,262	98,926
WTI oil price - \$US/barrel	\$ 25.90	\$ 30.20	\$ 19.24
Average exchange rate	1.55	1.49	1.49
WTI oil price - \$Cdn	\$ 40.09	\$ 44.87	\$ 28.59
Quality differential and transportation	\$ 7.72	\$ 3.10	\$ 6.04
Lexxor oil price (\$Cdn/barrel)	\$ 32.37	\$ 41.77	\$ 22.55
Lexxor gas price (\$Cdn/Mcf)	\$ 5.30	\$ 5.58	\$ 2.75

MANAGEMENT'S DISCUSSION AND ANALYSIS

Netbacks

Barrel of Oil Equivalent Cash Netback

The average cash netback price (after general and administrative expenses and interest on long term debt) received during 2001 was \$13.94 per Boe, down 17% from \$16.83 per Boe received in 2000 period. This average cash netback price results from an average natural gas netback price of \$1.81 per Mcf received in 2001 versus an average of \$3.19 per Mcf received in 2000 and an average oil and NGLs netback price of \$20.30 per Bbl received in 2001 versus an average of \$27.29 per Bbl received in 2000. General and administrative expenses reduced the average Boe operating netback of \$18.06 per Boe (\$22.61 per Boe in 2000) by \$3.23 per Boe in 2001 versus \$4.62 per Boe in 2000 with interest expense further reducing the average cash netback by \$0.89 per Boe in 2001 compared to \$1.16 per Boe in 2000.

Commodity Netback

	Oil and NGLs (Bbl)			Natural Gas (Mcf)		
	2001	2000	1999	2001	2000	1999
Sales - total	388,692	77,116	28,903	723,840	618,876	40,139
- per day	1,065	211	79	1,983	1,696	1,151
Revenue	\$ 32.37	\$ 41.77	\$ 22.55	\$ 5.30	\$ 5.58	\$ 2.75
Hedging	-	-	-	(0.08)	(0.06)	-
Royalties	(7.05)	(6.68)	(4.20)	(1.75)	(1.22)	(0.55)
ARTC	0.52	0.07	(0.01)	0.23	0.10	0.15
Operating	(5.54)	(7.87)	(10.23)	(1.89)	(1.21)	(0.82)
Operating netback	\$ 20.30	\$ 27.29	\$ 8.11	\$ 1.81	\$ 3.19	\$ 1.53

Operating Cash Netback

	2001	2000	1999
Sales (Boe) - total	509,332	180,262	98,926
- per day	1,395	494	271
Revenue	\$ 32.24	\$ 37.01	\$ 18.26
Hedging	(0.12)	(0.22)	-
Royalties	(7.87)	(7.04)	(3.56)
ARTC	0.72	0.39	0.68
Operating	(6.91)	(7.53)	(6.42)
Operating netback	\$ 18.06	\$ 22.61	\$ 8.96
General and administrative	(3.23)	(4.62)	(4.61)
Interest	(0.89)	(1.16)	(0.74)
Cash netback	\$ 13.94	\$ 16.83	\$ 3.61

MANAGEMENT'S DISCUSSION AND ANALYSIS

Earnings

The significant production increase during the year (up 183%) increased petroleum and natural gas sales and the increase in interest and other income combined to offset reduced product prices (down 13% per Boe) increasing revenues 149% to \$16.5 million from \$6.6 million in 2000. Despite the resulting increases in operating, general and administrative, interest, depletion and depreciation expenses and provision for future income taxes, Lexxor's net earnings increased 35% to \$1.8 million (\$0.17 per share basic and \$0.16 per share diluted) in 2001 from \$1.3 million (\$0.22 per share basic and \$0.21 per share diluted) in 2000.

Earnings Netback

\$/Boe	2001	2000	1999
Cash netback	13.94	16.83	3.61
Depletion, depreciation, and site restoration	(8.08)	(5.96)	(3.46)
Future income taxes	(2.59)	(3.44)	0.00
Earnings netback	3.27	7.43	0.15

Cash Flow from Operations

Cash flow from operations increased 136% in 2001 to \$7.3 million (\$0.68 per share basic and \$0.66 per share diluted) from \$3.1 million (\$0.50 per share basic and diluted) in 2000. The increase is attributable to higher production offset by slightly lower average product prices in 2001.

	Petroleum and Natural Gas Sales \$M	Cash Flow From Operations \$M	Basic Per Share \$	Diluted Per Share \$	Earnings (Loss) \$M	Basic Per Share \$	Diluted Per Share \$
1999 Q1	352	16	0.00	0.00	(64)	(0.02)	(0.02)
Q2	474	9	0.00	0.00	(152)	(0.04)	(0.04)
Q3	445	236	0.06	0.06	(108)	(0.03)	(0.03)
Q4	536	96	0.03	0.03	339	0.09	0.09
Total ⁽¹⁾	1,807	357	0.10	0.10	15	0.00	0.00
2000 Q1	523	32	0.00	0.00	(36)	0.00	0.00
Q2	990	331	0.05	0.05	140	0.02	0.02
Q3	1,659	692	0.11	0.11	406	0.06	0.06
Q4	3,460	2,055	0.26	0.26	830	0.11	0.10
Total ⁽¹⁾	6,632	3,110	0.50	0.50	1,340	0.22	0.21
2001 Q1	3,643	1,708	0.15	0.15	578	0.05	0.05
Q2	3,517	1,559	0.15	0.15	384	0.05	0.05
Q3	4,753	2,026	0.19	0.19	579	0.05	0.05
Q4	4,449	2,052	0.17	0.17	266	0.02	0.02
Total ⁽²⁾	16,362	7,345	0.68	0.66	1,807	0.17	0.16

(1) Total cash flow from operations and earnings per share will vary from quarterly per share figures due to weighting of shares.

MANAGEMENT'S DISCUSSION AND ANALYSIS

With the expected continual increase in our production base and the current stable commodity price environment, cash flow from operations in 2002 should increase steadily to approximately \$11.0 million continuing the trend established over the past few years.

With the increased cash flow generated from operations in combination with the proceeds from the sale of non-core properties and from the sale of flow-through shares, Lexxor is planning a capital expenditure program totaling \$11.5 million. These initiatives should not only allow Lexxor to fund a reasonable exploration and development program but also allow us to re-establish a conservative fiscal policy.

Fourth Quarter 2001

While production increased significantly in the 4th quarter of 2001, (up 137%), commodity prices declined dramatically resulting in an increase in petroleum and natural gas sales, cash flow remaining similar to that of a year ago and 4th quarter 2001 earnings lower than reported in the 4th quarter of 2000.

Production averaged 2,002 Boe/d during the 4th quarter of 2001 versus 843 Boe/d during the comparative period in 2000. Average prices declined in 4th quarter of 2001 from the 4th quarter of 2000. The average price for oil and NGLs declined 42% to \$25.23 per Bbl (\$43.62 per Bbl in Q4 2000), natural gas dropped 61% to average \$3.08 per Mcf (\$7.85 per Mcf in Q4 2000). On a Boe basis, the 4th quarter of 2001 averaged \$24.16 per Boe down 47% from \$45.15 per Boe in 2001.

During the 4th quarter of 2001, petroleum and natural gas sales increased 29% to \$4.4 million from \$3.5 million in 2000, cash flow from operations was the same totaling \$2.1 million for both periods and earnings declined from \$830,334 in the 4th quarter of 2000 to \$265,708 in the 4th quarter of 2001. Higher operating, general and administrative and interest expenses offset higher revenues resulting in cash flow from operations remaining constant at \$2.1 million, \$0.17 per share basic and diluted in Q4 2001 versus \$0.26 per share basic and diluted in Q4 2000. Higher depreciation, depletion and site restoration expenses and an increased provision for future income taxes in 2001 contributed to the decline in 2001 earnings from \$830,334 in Q4 2000, \$0.11 per share basic and \$0.10 per share diluted, to \$265,708, \$0.02 per share basic and diluted in Q4 2001.

Revenue

Total petroleum and natural gas sales increased 147% in 2001 to \$16.4 million from \$6.6 million in 2000. This increase, despite reduced average product prices, was attributable to higher production (up 183%). Production increased year over year as a result of two property acquisitions and the implementation and continuation of a successful development and exploitation program.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Natural gas revenue, despite normal natural production declines and a 5% average price decline, increased 11% to total \$3.8 million (\$3.4 million in 2000). This increase is due primarily to a gas well at Antelope, Alberta being on production the entire year and the discovery of a natural gas pool at Neutral Hills. Oil and NGLs revenue increased 291% to \$12.6 million (\$3.2 million in 2000) due primarily to exploitation of acquired production at Ingoldsby, Edenvale and Redvers, Saskatchewan and increased production from drilling at Neutral Hills, Alberta.

Petroleum and Natural Gas Revenue by Area

	2001		2000		1999	
	\$M	% of Total	\$M	% of Total	\$M	% of Total
Neutral Hills	4,459	27	560	8	0	0
Redvers	2,568	16	0	0	0	0
Antler	2,385	15	1,717	26	0	0
Ingoldsby	1,400	9	389	6	207	11
Antelope	1,200	7	597	9	120	7
Edenvale	903	5	0	0	0	0
Monitor	776	5	998	15	778	43
Nisku	648	4	1,035	15	0	0
Court	376	2	451	7	262	15
Garrington	325	2	387	6	37	2
Taber South	287	2	0	0	0	0
Minor properties	1,035	6	498	8	403	22
Total	16,362	100	6,632	100	1,807	100

Royalties

Royalties paid on production, including the Saskatchewan resource surcharge, as a percentage of revenue increased in 2001 to approximately 25% of revenues versus approximately 19% in 2000. This increase results from the expiration of a royalty holiday and low royalty rate period on some production and the higher royalty burdens existing on some purchased production. Lexxor had expected the royalty rate to increase in 2001 and expects the rate to remain constant during 2002. On a Boe basis, royalties increased from \$7.04 per Boe in 2000 to \$7.87 per Boe in 2001.

Royalties on natural gas totaled \$1.3 million (34% of natural gas revenue) versus \$0.8 million (22% of natural gas revenue) in 2000. In 2001, Crown royalties totaled \$0.8 million (\$0.4 million in 2000) with freehold, overrides and other burdens totaling \$0.5 million (\$0.4 million in 2000).

MANAGEMENT'S DISCUSSION AND ANALYSIS

Royalties on oil and NGLs totaled \$2.7 million (21% of oil and NGLs revenue) versus \$0.5 million (16%) in 2000. In 2001, Crown royalties totaled \$1.9 million (\$0.2 million in 2000) with freehold, overrides and other burdens totaling \$0.8 million (\$0.3 million in 2000).

Alberta Royalty Tax Credit (ARTC)

The ARTC provides a royalty credit against a maximum of \$2.0 million of royalties payable to the Crown based on a price sensitive formula of between 25% and 75%. The royalty rate in 2001 was at the program's minimum of 25%, slightly lower than in 2000 (26%). In 2001, the ARTC reduced total Alberta royalties paid by \$0.4 million versus \$0.1 million in 2000. Lexxor's increased claim is related to Crown royalties paid on the oil wells drilled during the year at Neutral Hills. This program is essential to small producers in an environment of low prices and provides some stabilization of cash flow during the periods of low commodity prices.

Operating Expenses

Operating expenses increased 159% (82% for natural gas and 255% for oil and NGLs) in 2001 totaling \$3.5 million versus \$1.4 million in 2000. This relative increase is consistent with our increase in production. On a Boe basis, operating expenses decreased to \$6.91 per Boe in 2001 from \$7.53 per Boe in 2000. Operating expenses for natural gas increased 56% per Mcf to \$1.89 per Mcf primarily as a result of natural production declines that reduced volumes and increased operating fees in some areas. Operating expenses per barrel for oil and NGLs were reduced 30% from \$7.87 per Bbl in 2000 to \$5.54 per Bbl in 2001. This decrease resulted from additional volumes in some areas (economies of scale), the ownership of facilities and improved field operating efficiencies.

General and Administrative Expenditures

Gross general and administrative expenditures totaled \$4.0 million in 2001, a 182% increase from \$1.4 million in 2000. Increased expenditures were primarily due to the higher number of employees and full time consultants required to handle the higher level of production and operator responsibilities, bonus payments to employees for achieving production targets during the year and the higher costs relating to new office space and general support expenditures including legal fees, engineering evaluation fees and other corporate expenses. Lexxor capitalizes those expenditures related to land, geological and geophysical activities and the overhead related to those activities. In 2001, Lexxor capitalized \$1.6 million of such expenditures, up from \$0.4 million in 2000. Overhead recoveries, resulting from Lexxor being operator, reduced total expenditures by \$0.8 million in 2001 up from \$0.2 million in 2000.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Net general and administrative expense (after capitalized overhead and overhead recovery) totaled \$1.6 million, up from \$0.8 million in 2000.

On a Boe basis, Lexxor incurred \$7.80 per Boe in 2001 (\$7.81 per Boe in 2000) of gross general and administrative expenditures and \$3.23 per Boe (\$4.62 per Boe in 2000) on a net after capitalized overhead and overhead recoveries.

Lexxor currently has 21 employees and utilizes consultants as required. It is expected, that even with additional increases in production and possibly additional property acquisitions, the number of employees and consultants required will not increase significantly in 2002. We expect that as production increases, our cost per Boe will continue to be reduced and will continue to be quite comparable with our industry peers.

General and Administrative Expense

	2001	2000	1999
Sales (Boe) - total	509,332	180,262	98,926
- per day	1,395	494	271
\$000			
Gross expenditures	3,974	1,407	977
Overhead recoveries	(761)	(204)	(72)
Capitalized overhead	(1,566)	(370)	(449)
Net expense	1,647	833	456
Gross expenditures per Boe	\$ 7.80	\$ 7.81	\$ 9.87
Net expense per Boe	\$ 3.23	\$ 4.62	\$ 4.61

Interest Expense

Interest expense increased in 116% in 2001 to \$0.5 million, up from \$0.2 million in 2000, due in part to the amount of bank debt increasing from 2000 by approximately \$10.7 million. Lexxor increased its debt level in 2001 to finance property acquisitions and to fund some of our capital expenditure program.

On a Boe basis, interest expense decreased and represents a cost of \$0.89 per Boe in 2001 versus \$1.16 per Boe in 2000.

Depreciation, Depletion and Site Restoration

Depreciation, depletion and site restoration expense increased in 2001 to \$4.1 million or \$8.08 per Boe from \$1.1 million or \$5.96 in 2000. In 2001, depletion and depreciation represents \$7.67 per Boe and abandonment and site restoration represents \$0.41 per Boe. Lexxor's depreciation, depletion and site restoration rate per Boe has increased due to acquisitions awaiting full exploitation of possible reserves, our investment in facilities (that aided in the reduction in operating expense per Boe) and due to higher field costs leading to generally higher industry finding costs.

MANAGEMENT'S DISCUSSION AND ANALYSIS

A liability of \$0.5 million (2000 - \$0.2 million) for site restoration and abandonment costs has been recognized in these financial statements based on total estimated costs related to future site restoration and abandonment costs of \$1.6 million. These total estimated costs increased in 2001 as a result of abandonment and site restoration liabilities assumed with our property acquisitions and new wells drilled during the year.

Future Income Taxes

Lexxor recorded a provision for future income taxes of \$1.3 million in 2001. Although not currently taxable, Lexxor needs to maintain a healthy capital budget and avoid the reliance on the issuance of flow-through shares to access capital. At December 31, 2001, Lexxor had exploration and development costs, unde depreciated capital costs, unamortized share issue costs and non-capital losses available for deduction against future taxable income of approximately \$26.0 million.

Additions to Capital Assets

Capital additions during 2001 totaled \$26.5 million and included \$9.0 million spent to acquire two producing properties in Saskatchewan. During 2001, Lexxor participated in the drilling of 43 (26.6 net) wells.

(\$000)	2001	2000	1999
Land	1,349	94	119
Geological and seismic	1,148	163	(85)
Drilling and completions	8,388	3,010	1,229
Well equipment and tie-ins	4,592	1,843	504
Direct general and administrative	1,566	370	426
Office furniture, equipment and other	133	34	10
	17,176	5,514	2,203
Purchase of property	9,352	8,464	403
Total capital additions	26,528	13,978	2,606
Sale of Property	(1,628)	(454)	(2,195)
Net capital additions	24,900	13,524	411

During 2001, Lexxor was able to capitalize on opportunities that presented themselves. In our southeast Saskatchewan core area, we completed two separate property purchases. Both of these acquisitions were one-off arrangements that circumvented the auction process that is normally utilized by sellers. Reactivation of existing wells; re-entry and drilling of new horizontal legs and the drilling of new horizontal and vertical wells significantly increased production from these properties. In order to finance these acquisitions, Lexxor increased its bank borrowings and financed the subsequent drilling with the issue of flow-through shares.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Lexxor acquired property at Redvers, Edenvale, Ingoldsby and Taber South. Also included with these acquisitions was a land base and seismic data that will allow Lexxor to further exploit the acquired properties. Lexxor, in 2001, undertook a program of aggressive drilling and development at Neutral Hills (\$6.0 million), Antler (\$2.0 million), Redvers (\$2.0 million) and Ingoldsby (\$0.6 million) and drilled exploration projects at Berry, Consort, Bigoray, Long Coulee, Pembina and Wilson Creek.

Lexxor realized \$1.6 million (\$2.2 million - 2000) of proceeds from the disposition of property at Antler, Garrington and from miscellaneous property interests.

Lexxor expects to maintain an active exploration and development program during 2002 with expenditures for land, seismic, drilling, facilities and tie-ins to total approximately \$11.5 million. Lexxor expects to drill 35 wells in 2002 at approximately 50% interest. In addition, Lexxor is focusing on an acquisition of natural gas assets. Depending on the availability of property meeting our criteria, we may complete an acquisition in 2002.

Financial Resources and Liquidity

Lexxor's capital requirements are met primarily through the generation of cash flow, the utilization of debt and from the issue of equity. In addition to these traditional capital sources and to generate additional funds for operating, the Company will occasionally dispose of properties that have either been fully exploited or do not continue to meet our operational and financial criteria. The Board of Directors has mandated that the debt to current cash flow ratio should be between 1 : 1 and 2 : 1. This ratio is currently at the higher end of the range as a result of the decision to acquire producing properties in 2001. This decision was made to utilize the leverage afforded the company during a period of low interest rates and with an undertaking to reduce the debt to cash flow ratio in 2002.

At December 31, 2001, Lexxor's total debt and working capital deficiency was \$16.5 million, up from \$4.6 million at December 31, 2000. This resulted primarily from our aggressive capital expenditure plan and from our property acquisition strategy employed during the year. In 2001, the Company generated cash flow from operations of \$7.3 million and issued a total of 3.5 million Common shares for net proceeds of \$5.8 million. Flow-through share offerings raised \$4.7 million, the exercise of warrants raised \$1.0 million and options exercised generated \$145,150. The Company also generated funds from the sale of non-core properties of \$1.6 million.

MANAGEMENT'S DISCUSSION AND ANALYSIS

As part of the Offer to Purchase Icon Energy Inc. in March 2000, the Company issued 3,782,172 warrants expiring June 30, 2001 to shareholders of Icon. Five warrants plus \$1.50 was required to purchase one Common share. In 2001, 671,493 Common shares were issued on the exercise of warrants raising \$1.0 million.

A total of 165,500 options were exercised in 2001 generating \$145,150.

Effective December 14, 2001, the Company sold certain gathering equipment and batteries ("the Equipment") for \$2,750,000 (see note 4(b) to the financial statements). Subsequent to February 28, 2002 certain amendments were made to the agreements. The annual minimum fixed fee was adjusted from \$687,500 per annum to \$840,000 in 2002 and 2003, \$660,000 in 2004 and \$410,000 in 2005. The option to repurchase the Equipment in January 2006 was deleted and the Company has the right to negotiate an additional term of at least two years under similar terms and conditions. This transaction enabled the Company to monetize a portion of their investment in gathering and processing facilities and fixes the rate of interest and the repayment terms on a portion of the Company's debt. This strategy, similar to hedging commodity prices, enables the company to more adequately control terms of its debt.

At the Annual and Special Meeting of Shareholders held on May 9, 2001, the Shareholders approved the consolidation and re-designation of the Class A shares of the Company as Common shares on the basis of one post-consolidated Common share for up to every five pre-consolidated Class A shares. Effective October 31, 2001, Lexxor consolidated and re-designated its Class A shares on the basis of one Common share for every five (5) Class A shares. At December 31, 2001, Lexxor had 13.4 million Common shares outstanding.

On December 14, 2001, Lexxor announced that the Canadian Venture Exchange (CDNX) had accepted a notice of Lexxor to make a normal course issuer bid. The notice provides that the Company may, during the 12-month period commencing December 20, 2001 and ending December 19, 2002 purchase on the CDNX up to 594,215 Common shares. A portion of the shares purchased will be used by the Company pursuant to its employee stock savings plan and the remainder will be cancelled. No purchases were made in 2001. In January and February 2002 the Company purchased 64,800 Common shares of which 16,357 were allocated to the employee stock savings plan and 48,443 are to be cancelled.

At December 31, 2001 Lexxor had total debt and working capital deficiency of \$16.5 million. The Company's credit facilities with a Canadian chartered bank consist of a revolving operating demand loan of \$12.5 million (Facility A) and a non-revolving acquisition/development demand loan of \$5.0 million (Facility B).

MANAGEMENT'S DISCUSSION AND ANALYSIS

At December 31, 2001, Lexxor had drawn \$10.8 million under Facility A and \$3.1 million under Facility B. Facility B is subject to principal repayments of \$100,000 per month.

Effective January 1, 2002, the Company prospectively adopted the presentation and disclosure of the Facility A and B demand loans as current liabilities as recommended by the Canadian Institute of Chartered Accountants.

In addition, Lexxor had an outstanding equipment loan totaling \$2.7 million of which \$387,000 is shown as a current liability. Lexxor's working capital deficiency of \$1.5 million will be funded using existing lines of credit.

At December 31, 2001, Lexxor's proven producing reserve base had increased 82% to \$34.2 million (PV10). New discoveries in 2002 at Neutral Hills (oil) and at Berry Creek (natural gas) have added to this value. Preliminary discussions with our banker indicate that our lending base can support an increased line of credit.

During 2001, Lexxor traded 3.8 million shares on the CDNX. The high for the year was \$3.10 (May), the low for the year was \$1.21 (December) and the closing price at December 31, 2001 was \$1.66. At year-end 2001, Lexxor had 13.4 million shares issued and outstanding, warrants expiring June 30, 2002 exercisable into 807,419 Common shares and 959,000 employee options to purchase Common shares outstanding at an average exercise price of \$1.68. In February 2002, Lexxor issued options to officers and directors exercisable at \$1.50 to purchase 340,000 Common shares and repriced 363,000 employee options at \$1.50.

With the prospect of increased production and stable pricing generating increased cash flow, an inventory of high-grade development and exploration prospects, and people committed to excellence, Lexxor expects 2002 to be a year of further growth producing substantial rewards for stakeholders.

Summary of Trading During 2001 ⁽¹⁾

Period	Price Range (\$)			(000)
	High	Low	Close	Volume
First quarter	2.15	1.45	2.10	526
Second quarter	3.10	1.75	1.95	2,113
Third quarter	2.25	1.40	1.40	291
Fourth quarter	2.10	1.21	1.66	850
				3,780

(1) Consolidation (5:1) and redesignation of shares occurred on October 31, 2001. Information is restated.

MANAGEMENT’S DISCUSSION AND ANALYSIS

Market Capitalization

Lexxor’s market capitalization at December 31, 2001 is calculated using the year end closing price of \$1.66 per share.

Common shares outstanding as at December 31, 2001	13,400,093
Closing market price as at December 31, 2001	\$ 1.66
	\$000
Market value of common shares	22,244
Long term debt	15,013
Provision for future removal and site restoration	450
Future income taxes	3,577
Working capital deficiency	1,453
Market capitalization as at December 31, 2001	42,737

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LEXXOR ENERGY INC.

FINANCIAL REPORTING

Management's Report**To the Shareholders of Lexxor Energy Inc.**

The financial statements of Lexxor Energy Inc. and other financial information included in this annual report have been prepared by management. It is management's responsibility to ensure that sound judgement, appropriate accounting principles and methods, and reasonable estimates have been used in the preparation of this information. They also ensure that all information presented is consistent with that reported in the financial statements.

Management is also responsible for developing internal controls over the financial reporting process. Management believes the system of internal controls, the review procedures and the established policies provide timely information and reasonable assurance as to the reliability and relevance of financial reports to management. Management also believes that Lexxor's operations are conducted in conformity with the law and with a high standard of business conduct.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The Board carries out this responsibility principally through its Audit Committee. The Committee, which consists of a majority of non-management directors, reviews the financial statements and annual report, and recommends them to the Board for approval. The Committee meets with management and external auditors to discuss internal controls, auditing matters and financial reporting issues. External auditors have full and unrestricted access to the Audit Committee. The Committee also recommends a firm of external auditors to be appointed by the Shareholders.



Douglas O. McNichol
President
& Chief Operating Officer

Calgary, Alberta
March 19, 2002



J. Paul Lawrence
Vice President, Finance &
Chief Financial Officer

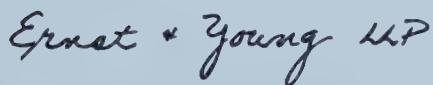
FINANCIAL REPORTING

Auditors' Report**To the Shareholders of Lexxor Energy Inc.**

We have audited the balance sheets of Lexxor Energy Inc. as at December 31, 2001 and 2000 and the statements of operations and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2001 and 2000 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

**Chartered Accountants**

Calgary, Canada

February 28, 2002

LEXXOR ENERGY INC.

FINANCIAL STATEMENTS

Balance Sheets

As at December 31

	2001 \$	2000 \$
Assets [note 6]		
Current		
Cash and cash held in trust [note 8(b)(iii)]	60,636	921,967
Short term investment	20,450	284,618
Promissory notes receivable [note 4(a)]	366,633	—
Accounts receivable	5,498,790	3,231,703
Loan receivable [note 4(b)]	2,500,000	—
Prepaid expenses	215,279	86,845
	8,661,788	4,525,133
Promissory note receivable [note 4(b)]	250,000	—
Capital assets [note 5]	37,563,822	16,569,731
	46,475,610	21,094,864

Liabilities and Shareholders' Equity

Current		
Accounts payable and accrued liabilities	8,527,593	6,063,090
Current portion of long term debt [note 6]	1,200,000	—
Current portion of long term equipment loan [note 4(b)]	387,000	—
	10,114,593	6,063,090
Long term debt [note 6]	12,650,000	3,100,000
Long term equipment loan [note 4(b)]	2,363,000	—
Future income taxes [note 9]	3,577,000	1,501,000
Future removal and site restoration [note 7]	449,988	240,000
	29,154,581	10,904,090
Commitments and contingencies [notes 4 and 10]		
Shareholders' equity		
Share capital [note 8]	19,332,598	14,009,393
Deficit	(2,011,569)	(3,818,619)
	17,321,029	10,190,774
	46,475,610	21,094,864

See accompanying notes

Approved by the Board:


Douglas O. McNichol

Director


Ronald J. Will

Director

LEXXOR ENERGY INC.

FINANCIAL STATEMENTS

Statements of Operations and Deficit

For the years ended December 31

	2001	2000
	\$	\$
Revenue		
Petroleum and natural gas sales	16,362,245	6,631,886
Royalties	(4,008,964)	(1,268,848)
Alberta Royalty Tax Credit	366,218	70,216
	12,719,499	5,433,254
Interest and other income	140,943	–
	12,860,442	5,433,254
Expenses		
Operating	3,520,089	1,356,942
General and administrative	1,646,743	833,246
Interest on long term debt	451,010	208,470
Depletion, depreciation and site restoration	4,115,000	1,075,000
	9,732,842	3,473,658
Earnings before income taxes	3,127,600	1,959,596
Provision for future income taxes [note 9]	1,320,550	620,000
Net earnings for the year	1,807,050	1,339,596
Deficit, beginning of year	(3,818,619)	(6,007,215)
Change in accounting policy [note 2]	–	849,000
Deficit, end of year	(2,011,569)	(3,818,619)
Net earnings per share		
Basic	\$ 0.17	\$ 0.22
Diluted	\$ 0.16	\$ 0.21
Weighted average number of shares		
Basic	10,857,075	6,167,745
Diluted	11,063,904	6,270,945

See accompanying notes

FINANCIAL STATEMENTS

Statements of Cash Flows

For the years ended December 31

	2001 \$	2000 \$
<i>Operating activities</i>		
Net earnings for the year	1,807,050	1,339,596
Items not affecting cash		
Provision for future income taxes	1,320,550	620,000
Depletion, depreciation and site restoration	4,115,000	1,075,000
General and administrative	102,225	75,500
Cash flow from operations	7,344,825	3,110,096
Net decrease in non-cash working capital balances	(1,257,721)	(1,336,226)
Cash provided by operating activities	6,087,104	1,773,870
<i>Financing activities</i>		
Increase in long term debt	10,750,000	1,650,000
Issue of common shares	6,188,819	2,973,381
Share and warrant issue costs	(380,389)	(154,318)
Cash provided by financing activities	16,558,430	4,469,063
<i>Investing activities</i>		
Expenditures on capital assets	(26,359,513)	(6,875,897)
Proceeds from sale of properties	564,277	453,500
Acquisition costs [note 3]	—	(548,206)
Change in non-cash working capital	2,288,371	1,640,287
Cash used in investing activities	(23,506,865)	(5,330,316)
<i>Net cash (used) provided</i>	(861,331)	912,617
<i>Cash and cash held in trust, beginning of year</i>	921,967	9,350
<i>Cash and cash held in trust, end of year</i>	60,636	921,967
<i>Cash flow from operations per share</i>		
Basic	\$ 0.68	\$ 0.50
Diluted	\$ 0.66	\$ 0.50

See accompanying notes

NOTES TO FINANCIAL STATEMENTS

For the years ended December 31, 2001 and 2000

1. Description of Business and Summary of Significant Accounting Policies

Lexxor Energy Inc. (the "Company" or "Lexxor") was incorporated under the laws of the Province of Alberta on August 8, 1995. The financial statements for the year ended December 31, 2000 were consolidated and included the accounts of the Company and its wholly owned subsidiary, DBM Energy Inc. ("DBM"). On February 14, 2001, DBM and the Company were amalgamated, continuing under the name of Lexxor Energy Inc.

The Company's business is the acquisition of and the exploration for and development and production of crude oil and natural gas in Canada. The Company's shares are listed for trading on the Canadian Venture Exchange ("CDNX").

During the year ended December 31, 2001, the Company reorganized its share capital whereby the issued and issuable Class A voting shares were exchanged for newly created Common voting shares at a ratio of five (5) Class A shares for one (1) Common share. The number of Common shares, Common share options and warrants outstanding, Common share prices and per share calculations for both current and prior periods have been restated to reflect this reorganization.

The financial statements of the Company have been prepared in accordance with Canadian generally accepted accounting principles. Because a precise determination of many assets and liabilities is dependent upon future events, the preparation of financial statements involves the use of estimates and approximations, which have been made using careful judgment. The financial statements have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the significant accounting policies summarized below.

(a) *Petroleum and natural gas properties*

Cost

The Company follows the full cost method of accounting for petroleum and natural gas properties, whereby all costs related to the acquisition of, exploration for and development of petroleum and natural gas properties and related reserves are capitalized. Such costs include land acquisition costs, geological and geophysical expenditures, and costs of drilling both productive and non-productive wells, tangible production equipment and that portion of general and administrative expenditures directly related to acquisition, exploration and development activities.

Capitalized costs, including tangible production equipment, are depleted and depreciated using the unit-of-production method based on estimated proven reserves of petroleum and natural gas before royalties as determined by an independent petroleum engineering firm, converting natural gas to an oil equivalent basis using six thousand cubic feet of natural gas for one barrel of petroleum.

Future removal and site restoration costs

Estimated future costs of site restorations, including the removal of production facilities at the end of their useful lives, are provided for on a unit of production basis. The estimate is based on currently known information, existing legislation and technology. Changes in these factors may result in material changes to estimated costs, which will be recognized prospectively when known. The annual provision is included in depletion, depreciation and site restoration expense. Actual expenditures incurred are applied against the accumulated liability.

Depreciation

Office furniture and equipment is depreciated on a straight-line basis per annum.

NOTES TO FINANCIAL STATEMENTS

Impairment

The Company applies a ceiling test to capitalized costs on an annual basis to ensure that such costs do not exceed the estimated undiscounted future net revenues from gross proven reserves. The calculation of the ceiling test considers prices and costs in effect at year end, plus the proceeds of undeveloped properties, less amounts associated with future general and administrative costs, financing costs and income tax expense. Where the estimated net recoverable amount is less than the net carrying amount of capitalized costs, then a write-down to the estimated net recoverable amount is recorded, with a charge to earnings. By their nature, these estimates are subject to measurement uncertainty and the impact on the financial statements of future years could be material.

Disposals

Proceeds from the disposal of properties are applied as a reduction of the cost of the remaining assets. However, when a disposal would change the depletion and depreciation rates by more than 20%, a gain or loss on disposal would be recorded.

Joint activities

Substantially all of the Company's exploration and production activities are conducted jointly with others and, accordingly, these financial statements reflect only the Company's proportionate interest in such activities.

Flow-through shares

The resource expenditure deductions for income tax purposes related to exploratory and development activities funded by flow-through share arrangements are renounced to investors in accordance with tax legislation. Under the liability method of accounting for income taxes, the future income taxes related to the temporary difference arising at the later of renunciation and when the qualifying expenditures are incurred, are recorded at that time together with a corresponding reduction to the carrying value of the shares issued.

(b) Credit risk

The majority of the Company's accounts receivable are in respect of petroleum and natural gas sales and drilling expenditures. Approximately 54% (2000 - 47%) of these transactions are to third parties. The Company views the credit risk with these parties as low.

(c) Income taxes

The Company has adopted the liability method of accounting for income taxes [note 2]. Under this method, future income tax liabilities and future income tax assets are recorded based on temporary differences - the difference between the carrying amount of an asset and liability in the balance sheet and its tax basis, the carry forward of unused tax losses and unamortized share issue costs. Future income tax assets and liabilities are measured using income tax rates expected to apply in the years in which temporary differences are expected to be recovered or settled. The effect on future income tax assets and liabilities of a change in tax rates is included in income in the period that the change is substantially enacted. Future income tax assets are evaluated and if realization is not considered "more likely than not", a valuation allowance is provided.

(d) Executive and Employee Share Options

The Company has established two stock option plans whereby the Company may grant options to purchase Common shares to its directors, officers, employees and consultants. Under the New Stock Option Plan, options are granted at the closing market price of the Common shares on the date immediately preceding the date of grant, vest over a two year period or as determined by the board of directors of the Company and expire no later than ten years from the date of grant. All future options are to be granted under the New Stock Option Plan. The options outstanding under the Prior Plan are exercisable over a five-year period and expire on January 15, 2004.

NOTES TO FINANCIAL STATEMENTS

No compensation expense is recognized when stock options are issued to employees. Any consideration paid on the exercise of stock options is credited to share capital.

2. Changes in Accounting Policy

Basic earnings and cash flow from operations per share were calculated on the basis of the weighted average number of shares outstanding for the year.

Effective January 1, 2001, the Company retroactively adopted the treasury stock method of computation, presentation and disclosure of diluted per share amounts as recommended by the Canadian Institute of Chartered Accountants ("CICA"). Under the treasury stock method, only "in the money" dilutive stock options and other instruments impact the diluted calculations. Proceeds obtained upon exercise of "in the money" options would be used to repurchase Common shares at the average market price during the year. The diluted weighted average number of Common shares is then calculated based on these assumed transactions.

Prior year diluted earnings per share and diluted cash flow per share have been restated to reflect this change. If the imputed earnings method had been used to calculate these amounts, there would not be a material dilutive effect on diluted earnings per share or diluted cash flow from operations per share.

Effective January 1, 2000, the Company adopted the liability method of accounting for income taxes as recommended by the CICA. Under the liability method, the Company records future income taxes for the effect of any difference between the accounting and income tax basis of an asset or liability recorded using the substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company has adopted the CICA recommendations on a retroactive basis without restatement of individual prior years by recording an increase to capital assets of \$1,700,000, a decrease in deficit of \$849,000, and an increase in the future income taxes of \$851,000. The additions to capital assets will be amortized to income over future years.

3. Acquisitions

(a) Icon Energy Limited

On April 3, 2000, pursuant to a Plan of Arrangement, Lexxor acquired all of the outstanding common shares of Icon Energy Limited ("Icon"). The acquisition has been accounted for using the purchase method and the purchase price has been allocated as follows:

	\$
Net working capital deficiency assumed	(679,669)
Capital assets	1,563,518
Future income tax asset	2,003,000
Long term debt assumed	(600,000)
Future removal and site restoration liability assumed	(39,599)
	<u>2,247,250</u>
Consideration	
1,889,751 Common shares issued	1,889,747
3,782,172 Lexxor warrants issued	—
Costs of acquisition	357,503
	<u>2,247,250</u>

Five warrants entitled the holder to acquire one (1) Common share of Lexxor for \$1.50 until June 30, 2001 (see Note 8(c)). No value was assigned to the warrants at the time of the Plan of Arrangement.

NOTES TO FINANCIAL STATEMENTS

The Plan of Arrangement required that Icon’s unsecured creditors agreed to settle a portion of their outstanding claims against Icon through the receipt of Lexxor Common shares valued at \$1.00 per share. As a result, Lexxor issued 376,750 Common shares in settlement of \$376,750 in Icon creditor claims, reducing the net working capital deficiency assumed to \$679,669. The operations of Icon have been included in the financial statements at December 31, 2000 from the date of acquisition.

On July 1, 2000, Icon and Lexxor were amalgamated, continuing under the name of Lexxor Energy Inc.

An adjustment of \$2,003,000 recognized the tax effect of the difference between the accounting and income tax basis of the Icon capital assets acquired as at April 3, 2000.

(b) DBM Energy Inc.

On December 29, 2000, pursuant to an Offer to Purchase, Lexxor acquired all of the outstanding common shares of DBM Energy Inc. (“DBM”). The acquisition has been accounted for using the purchase method and the purchase price has been allocated as follows:

	\$
Net working capital deficiency assumed	(443,856)
Capital assets	4,297,856
Future income tax liability	(1,127,000)
Future removal and site restoration liability assumed	(60,000)
	2,667,000
Consideration	
1,415,027 Common shares issued	2,476,297
3,537,405 Lexxor warrants issued	–
Costs of acquisition	190,703
	2,667,000

Five (5) Lexxor warrants will enable the holder to acquire one Common share at \$3.00 [see note 8(c)] until June 30, 2002. No value was assigned to the warrants at the time of the Offer to Purchase.

The operations of DBM have been included in these financial statements from the date of acquisition.

An adjustment of \$1,127,000 recognized the tax effect of the difference between the accounting and income tax basis of the DBM capital assets acquired as at December 29, 2000.

4. Related Party Transactions

(a) Promissory Notes Receivable

In March 2001, Lexxor sold certain oil and gas properties for \$333,333 to a company controlled by Lexxor’s Chairman and CEO (“Related Party”). The Company accepted as partial payment a promissory note, bearing interest at prime plus 1% per annum, totaling \$233,333 which is included in Promissory notes receivable of \$366,633 at year end. This note is due by November 1, 2002. As at December 31, 2001, the prime lending rate was 4.00%. Interest earned and paid by the Related Party in 2001 was \$12,814.

NOTES TO FINANCIAL STATEMENTS

Lexxor has also guaranteed to the Related Party the annual cash flow from the properties sold from November 1, 2000 to November 1, 2002, excluding capital costs (the "Annual Guarantee") to be not less than \$80,000. Where the annual cash flow exceeds the Annual Guarantee, the excess will be equally apportioned to the Company and the Related Party. To November 1, 2001, payments made under the Annual Guarantee total approximately \$10,000.

(b) Sale of Facilities

Effective December 14, 2001, the Company sold certain gathering equipment and batteries ("the Facilities") at Neutral Hills, Alberta and at Redvers, Edenvale, and Antler, Saskatchewan, for proceeds of \$2,750,000 ("the Proceeds") to Lexxor Equipment Financing Limited Partnership ("the Partnership").

Concurrently, Lexxor entered into a Processing Agreement with the Partnership to utilize the Facilities from January 1, 2002 to December 31, 2005 ("the Agreement Term") at an annual minimum fixed fee of \$687,500 on a take or pay basis. Lexxor has committed to process all present and future production from the Neutral Hills, Redvers, Edenvale, and Antler areas through the Facilities during the Agreement Term and will continue to operate and manage the Facilities.

Processing fees paid in excess of the annual minimum fixed fee will be credited to an "Excess Account" maintained by the Partnership. The balance in the Excess Account at the end of the Agreement Term will be applied toward the stipulated repurchase cost of the Facilities. As at January 1, 2006, Lexxor will have the option to repurchase the Facilities at a cost of \$1,400,000 ("the Option"), which is estimated to be the fair market value of the Facilities at that date. In the event that the Option is not exercised, Lexxor will lose its rights to the Excess Account and a new Processing Agreement with a minimum term of two years will then be negotiated.

One director of Lexxor is the controlling shareholder of the General Partner of the Partnership. Three directors of Lexxor own approximately 37% of the limited partner units in the Partnership.

Concurrently, the Partnership negotiated a sale of the Facilities, a thirty-seven month (37) Leaseback Agreement, and an Option to Repurchase the Facility, indirectly with a financial institution ("the Sale Leaseback Transaction"). The General Partner is entitled to receive a fee of \$240,000 from the equity proceeds receivable by the Partnership of \$3,000,000. The General Partner will also receive \$200,000 of the Option cost of \$1,400,000 if Lexxor exercises the Option to repurchase the Facilities.

If a change in control of Lexxor occurs, the Partnership shall assume operatorship of the Facilities. Lexxor will pay a contract termination payment of \$950,000 and an amount equal to the balance payable by the Partnership relating to the Sale Leaseback Transaction, less the balance of the Excess Account.

The terms of the transaction provide reasonable assurance that Lexxor will obtain ownership of the Facilities by exercising the Option. Accordingly, under Canadian generally accepted accounting principles, the transaction is accounted for as a financing transaction rather than a sale whereby the processing payments and the Option are recorded as repayments of the principal and interest on a loan of \$2,750,000. The effective interest rate on the loan is 17.57%.

The proceeds due to Lexxor from the Partnership relating to this financing transaction are reflected on the balance sheet as a current Loan receivable of \$2,500,000 bearing interest at prime plus 1% with principal and interest to be paid on March 31, 2002 and a long term Promissory note receivable of \$250,000. Interest earned and receivable on the current Loan receivable to December 31, 2001 was \$5,822.

NOTES TO FINANCIAL STATEMENTS

5. Capital Assets

	December 31 2001 \$	December 31 2000 \$
Petroleum and natural gas properties	41,045,232	22,415,791
Production equipment	12,194,583	6,057,958
	53,239,815	28,473,749
Office furniture and equipment	306,157	173,131
	53,545,972	28,646,880
Accumulated depletion and depreciation	(15,982,150)	(12,077,149)
	37,563,822	16,569,731

Undeveloped properties with a cost of \$2,500,000 at December 31, 2001 (2000 - \$650,000) have been excluded from costs subject to depletion and depreciation.

During the year ended December 31, 2001, the Company capitalized \$1,565,894 (2000 - \$370,000) of general and administrative expenditures related to acquisition, exploration and development activities.

6. Long Term Debt

	December 31 2001 \$	December 31 2000 \$
Facility A:		
Revolving Operating Demand Loan at prime rate plus 0.50% averaging 6.5% (2000 - 8.5%)	2,750,000	1,645,000
Bankers Acceptances at variable rates averaging 4.24%	8,000,000	—
Facility B:		
Non-revolving Acquisition/Development Demand Loan at prime rate plus 1.00% averaging 7.00% (2000 - 8.75%)	3,100,000	1,455,000
	13,850,000	3,100,000
Current portion - Facility B	1,200,000	—
	12,650,000	3,100,000

Facility A for \$12.5 million includes drawings relating to cheques outstanding of \$2,500,000 at December 31, 2001. This facility is allowed to revolve and fluctuate at the Company's discretion without fixed repayment terms and is subject to an annual review.

Facility B is available to a maximum amount of \$5.0 million at December 31, 2001. As of November 28, 2001, the Company is required to make monthly principal repayments of \$100,000.

At December 31, 2001, the lender has indicated that they will not demand repayment of the loans prior to December 31, 2002 providing no adverse change in the financial condition of the Company has occurred. Accordingly, the loans have been classified as long term.

A \$25,000,000 Supplemental Debenture covering all assets of the Company provides the collateral for Facilities A and B. These credit facilities are subject to commitment fees, the amounts of which are not significant.

Cash interest paid approximates interest expense.

NOTES TO FINANCIAL STATEMENTS

7. Future Removal and Site Restoration

At December 31, 2001, the total estimated costs relating to future site restoration and well abandonment are estimated to be \$1,630,000 (2000 - \$900,000) of which \$449,988 (2000 - \$240,000) has been recorded in the financial statements as a liability. Factors such as inflation and changes in technology may materially change the cost estimate.

8. Share Capital

(a) Authorized

Unlimited number of Common voting shares

Unlimited number of Class B voting shares

(b) Issued and issuable

	December 31, 2001		December 31, 2000	
	Number of Shares	Amount \$	Number of Shares	Amount \$
Common shares				
Balance, beginning of year	9,873,750	14,009,393	2,651,714	3,918,480
Issued on exercise of warrants [note 8(c)]	671,493	1,007,334	9,255	13,882
Issued pursuant to flow-through share offerings [iii]	2,689,350	5,306,560	1,937,647	2,800,000
Issued on exercise of stock options	165,500	145,150	-	-
Issued on Icon acquisition to shareholders and creditors [note 3(a)]	-	-	1,889,751	1,889,747
Issued for cash pursuant to private placement	-	-	300,000	300,000
Issued to acquire Bluestone assets [i]	-	-	300,000	300,000
Issued on conversion of Class B shares [ii]	-	-	1,370,356	3,133,305
Issued on acquisition of DBM Energy Inc. [note 3(b)]	-	-	1,415,027	2,476,297
Issue costs net of future income taxes	-	(220,389)	-	(85,318)
Tax benefits renounced	-	(915,450)	-	(737,000)
Balance, end of year	13,400,093	19,332,598	9,873,750	14,009,393
Class B shares				
Balance, beginning of year	-	-	1,370,356	3,133,305
Converted to Class A Shares [ii]	-	-	(1,370,356)	(3,133,305)
Balance, end of year	-	-	-	-
		19,332,598		14,009,393

- (i) In August 2000, the Company issued 300,000 Common shares valued at \$1.00 per Common share as partial consideration for the acquisition of certain petroleum and natural gas properties owned by Bluestone Resources Inc. ("Bluestone"). The balance of the \$700,000 purchase price due to Bluestone of \$400,000 was paid in cash.
- (ii) In April 2000, the Company issued 1,370,356 Common shares on the conversion of 1,370,356 Class B shares.

NOTES TO FINANCIAL STATEMENTS

(iii) The following is a continuity of Common flow-through shares issued and outstanding:

December 31, 2001			December 31, 2000		
Date	Number of Shares	Amount \$	Date	Number of Shares	Amount \$
March	250,000	500,000	September	1,120,000	1,150,000
August	657,183	1,478,660	October	250,000	500,000
October	266,667	600,000	December	567,647	1,150,000
December	1,515,500	2,727,900		1,937,647	2,800,000
	2,689,350	5,306,560			

During the year ended December 31, 2001, 8% (2000 – 23%) of the flow-through shares issued were issued to employees, consultants and directors.

In 2002, the Company is required to incur \$3,000,000 of qualified expenditures relating to the issuance of Common flow-through shares in 2001.

In December 2000, the Company entered into an agreement with MRF 2000 Limited Partnership (“MRF”) to issue 250,000 Common flow-through shares under a private placement at \$2.00 per Common flow-through share for gross proceeds of \$500,000. At December 31, 2000, the funds were held in-trust for the Company pending the Company issuing the forms prescribed in the Income Tax Act (Canada), incurring qualifying expenditures of \$500,000 and issuing the shares. The Company renounced for income tax purposes exploration and development expenditures of \$500,000 to MRF effective December 31, 2000. In February 2001, the Company had incurred all of the qualifying expenditures as required under the agreement with MRF and received \$500,000 from the funds held in trust on March 9, 2001.

In December 2000, the Company entered into an agreement with Petrovest VII Flow-through Share Limited Partnership (“Petrovest”) to issue 117,647 Common flow-through shares under a private placement at \$2.125 per Common flow-through share for gross proceeds of \$250,000. At December 31, 2000, the funds were held in-trust for the Company pending the Company issuing the forms prescribed in the Income Tax Act (Canada) and the Taxation Act (Quebec), incurring qualifying expenditures of \$250,000, and issuing the shares. The Company renounced for income tax purposes exploration and development expenditures of \$250,000 to Petrovest effective December 31, 2000. In March 2001, the Company incurred all of the qualifying expenditures as required under the agreement with Petrovest and received \$250,000 plus interest earned from the funds held in trust on March 13, 2001.

(c) Warrants

As part of the offer to purchase DBM in December 2000, the Company issued 3,537,405 warrants expiring June 30, 2002 to shareholders of DBM. Five (5) warrants plus \$3.00 are required to purchase one Common share. At December 31, 2001, 3,537,093 DBM warrants were outstanding which are exercisable into 707,419 Common shares. In the year ending December 31, 2001, 315 DBM warrants were exercised resulting in the issuance of 63 Common shares for proceeds of \$187.

As part of a private placement of flow-through shares in December 2000, the Company issued 500,000 purchase warrants expiring June 30, 2002. Five (5) warrants plus \$3.00 are required to purchase one Common share. These warrants are exercisable into 100,000 Common shares and are outstanding at December 31, 2001.

As part of the offer to purchase Icon in March 2000, the Company issued 3,782,172 warrants expiring June 30, 2001 to shareholders of Icon. Five (5) warrants plus \$1.50 was required to purchase one (1) Common share. In the year ending December 31, 2001, 3,357,150 (2000 - 46,275) warrants had been exercised resulting in the issuance of 671,430 Common shares for proceeds of \$1,007,147. In total, 378,747 warrants expired unexercised.

NOTES TO FINANCIAL STATEMENTS

(d) Executive and Employee Common Share Options

The following is a continuity of stock options outstanding for which shares have been reserved:

	December 31, 2001		December 31, 2000	
	Number of Shares (000s)	Weighted Average Exercise Price \$	Number of Shares (000s)	Weighted Average Exercise Price \$
Outstanding at beginning of year	559	1.58	194	3.98
Granted	661	1.94	435	1.03
Exercised	(169)	(0.88)	-	-
Cancelled	(92)	(4.41)	(70)	(4.82)
Outstanding at end of year	959	1.68	559	1.58

The following table is an analysis of outstanding and exercisable stock options as at December 31, 2001:

Outstanding			Exercisable	
Exercise Price \$	Options Outstanding at December 31, 2001 (000s)	Weighted Average Remaining Contractual Life (years)	Exercise Price \$	Options Exercisable at December 31, 2001 (000s)
0.75	30	1.42	-	-
0.90	132	1.33	-	-
0.95	10	1.17	0.95	5
1.25	80	2.08	1.25	80
1.32	7	2.42	-	-
1.40	36	2.25	-	-
1.65	45	1.50	-	-
1.70	70	1.54	-	-
1.75	206	1.61	1.75	28
1.80	35	1.58	1.80	3
1.95	169	1.75	-	-
2.50	112	1.33	-	-
2.60	8	1.83	-	-
2.70	19	1.83	-	-
	959			116

In May 2001, at the Company's Annual Meeting, the shareholders approved a maximum of 980,000 Common shares be reserved for issuance. The Company will be requesting shareholder approval to increase the maximum number of shares reserved for issuance at the Company's next Annual Meeting.

Effective February 4, 2002, 363,000 employee share options were re-priced at \$1.50 per option.

(e) Normal course issuer bid

The Company has received approval from CDNX to repurchase up to 594,215 Common shares at the market price at the time of acquisition beginning December 20, 2001 and ending December 19, 2002. No shares were repurchased in 2001.

NOTES TO FINANCIAL STATEMENTS

9. Future Income Taxes

The Company has an effective tax rate, which differs from the expected Canadian income tax rate. The differences are as follows:

	December 31 2001 \$	December 31 2000 \$
Statutory tax rate	42.49%	44.62%
Computed expected tax provision	1,328,917	874,372
Increase (decrease) resulting from:		
Resource allowance	(983,166)	(424,470)
Crown charges	1,149,934	235,138
ARTC	(155,606)	(31,330)
Other	(19,529)	(33,710)
Provision for future income taxes	1,320,550	620,000

The Company had the following tax pools available for deduction against future taxable income:

	December 31 2001 \$	December 31 2000 \$
Exploration costs	9,873	4,218
Development costs	6,294	2,873
Undepreciated capital costs	7,117	4,563
Unamortized share issue costs	427	224
Non-capital losses	2,313	822
	26,024	12,700

Future income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts for income tax purposes. The components of the Company's future income tax assets and liabilities are as follows:

	December 31 2001 \$	December 31 2000 \$
Net book value of capital assets in excess of tax pools	(5,046)	(2,146)
Tax loss carry forwards recognized	983	367
Site restoration	191	107
Share issue costs	182	100
Alberta royalty deduction	113	71
Future tax liability	(3,577)	(1,501)

NOTES TO FINANCIAL STATEMENTS

10. Commitments and Contingencies

(a) Operating Commitments

In order to ensure continued availability of, and access to facilities and services to meet its operational requirements, the Company has entered into non-cancelable operating leases for office space and other property and equipment. Under contracts existing at December 31, 2001, future minimum amounts payable under these leases and agreements are as follows:

	\$
2002	307,291
2003	97,266
2004	1,041
	405,598

Pursuant to a natural gas sales supply contract, the Company had committed to supply 500 gigajoules per day of natural gas at \$4.65 per gigajoule until March 31, 2001.

The Company had no financial commodity price contracts in place at December 31, 2001.

(b) Contingencies

The Company is subject to various regulatory and statutory requirements relating to the protection of the environment. These requirements, in addition to contractual agreements and management decisions, result in the accrual of estimated future removal and site restoration costs. These costs are accrued on the unit of production basis. Any changes in these estimates will affect future earnings.

Costs attributable to these commitments and contingencies are expected to be incurred over an extended period of time and are to be funded mainly from the Company's cash provided by operating activities. Although the ultimate impact of these matters on net earnings cannot be determined at this time, it could be material for any one quarter or year.

11. Balance Sheet Financial Instruments

The Company's financial instruments recognized in the balance sheet consist of cash and cash held in trust, short term investment, promissory notes receivable, accounts receivable, loan receivable, accounts payable and accrued liabilities, long-term debt, and long term equipment loan.

The estimated fair value of recognized financial instruments have been determined based on the Company's assessment of available market information and appropriate valuation methodologies; however, these estimates may not necessarily be indicative of the amounts that could be realized or settled in a future market transaction.

The fair values of these financial instruments approximate their carrying amounts.

12. Comparative Figures

Certain comparative figures have been reclassified to conform to the current year's financial statement presentation.

6

LEXXOR ENERGY INC.

SUPPLEMENTARY INFORMATION

Quarterly Summary

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Year 2001
Financial (\$000, except per share)					
Oil and gas revenues	3,643	3,517	4,753	4,449	16,362
Cash flow from operations	1,708	1,559	2,026	2,052	7,345
Per share - diluted	0.15	0.15	0.19	0.17	0.66
Net earnings	578	384	579	266	1,807
Per share - diluted	0.05	0.05	0.05	0.02	0.16
Capital expenditures	6,761	5,854	3,911	9,833	26,359
Bank debt and working capital deficiency	8,786	12,145	12,889	16,466	16,466
Operating (Units as noted)					
Production					
Oil and NGLs (Bbls/d)	592	750	1,220	1,684	1,065
Natural gas (Mcf/d)	2,305	1,663	2,058	1,910	1,983
Total Boe/d (6:1)	976	1,028	1,563	2,002	1,395
Average selling price					
Oil and NGLs (\$/Bbl)	37.73	37.54	36.54	25.23	32.37
Natural gas (\$/Mcf)	7.87	6.36	3.44	3.08	5.30
Total production (\$/Boe)	41.47	37.61	33.05	24.16	32.24
Netback					
Oil and NGLs (\$/Bbl)	23.30	23.57	22.48	15.64	20.30
Natural gas (\$/Mcf)	4.18	2.30	0.58	0.52	1.81
Total production (\$/Boe, 6:1)	23.99	19.84	18.31	13.65	18.06

CORPORATE INFORMATION

Directors

J. Gordon Ironside ⁽¹⁾

Chairman & Chief Executive Officer
Lexxor Energy Inc.

Douglas O. McNichol ⁽²⁾

President & Chief Operating Officer
Lexxor Energy Inc.

Larry Nachshen

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Vice-President & Secretary Treasurer
Mi Casa Rentals Inc.
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Carl M. Ravinsky

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Ronald J. Will ⁽¹⁾ ⁽²⁾

Investment Advisor
National Bank Financial
Calgary, Alberta

(1) Member of the Audit Committee

(2) Member of the Compensation Committee

Officers and Senior Personnel

J. Gordon Ironside

Chairman & Chief Executive Officer

Douglas O. McNichol

President & Chief Operating Officer

J. Paul Lawrence

Vice-President, Finance and Chief
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B. Cameron Dawes

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Telephone: (403) 571-8100

Facsimile: (403) 571-8118

Website: <http://www.lexxor.com>

Auditors

Ernst & Young LLP

Calgary, Alberta

Banker

National Bank of Canada

Calgary, Alberta

Evaluation Engineers

Chapman Petroleum Engineering Ltd.

Calgary, Alberta

Legal Counsel

Heenan Blaikie

Calgary, Alberta

Gowling, Lafleur Henderson LLP

Calgary, Alberta

Registrar and Transfer Agent

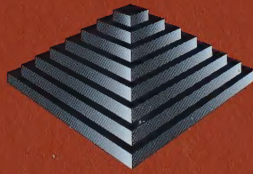
Valiant Corporate Trust Company

Calgary, Alberta

Stock Exchange Listing

Canadian Venture Exchange

Trading Symbol: LXX



LEXXOR
ENERGY INC.

Annual Report 2001

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